Easy on the Mayo Please: Why Judicial Deference should not be Extended to Regulations that Violate the Administrative Procedure Act

Niki R. Ford

Follow this and additional works at: https://dsc.duq.edu/dlr

Recommended Citation
Available at: https://dsc.duq.edu/dlr/vol50/iss4/3

This Article is brought to you for free and open access by Duquesne Scholarship Collection. It has been accepted for inclusion in Duquesne Law Review by an authorized editor of Duquesne Scholarship Collection.
Easy on the MAYO Please: Why Judicial Deference Should Not Be Extended to Regulations that Violate the Administrative Procedure Act

Niki R. Ford*

I. INTRODUCTION ............................................................... 800
II. THE BACKGROUND OF THE APA AND IRS RULEMAKING ............................................................... 806
   A. The Basics of APA Rulemaking .................................................. 809
   B. The Treasury's Failure to Play by the Rules of Rulemaking .................. 812
III. THE HISTORY AND CURRENT STATE OF JUDICIAL DEFERENCE TO AGENCY REGULATIONS ........... 817
   A. Transferring Power with the Chevron Two-Step ............................................... 819
   B. Administrative Power Reinforced: Post-Chevron Decisions ............................. 822
      1. United States v. Mead Corp............................................. 822
      2. National Cable & Telecommunications Ass'n v. Brand X Internet Services .... 823
      3. Mayo Foundation for Medical Education and Research v. United States........ 826
      1. Home Concrete—The One to Reach the Big Stage ...................................... 832
      2. The Rest of the Overstated Bases Cases—Inconsistency Reigns Supreme ...... 839
IV. AGENCY REGULATIONS THAT VIOLATE THE APA FAIL TO QUALIFY FOR DEFERENCE UNDER STEP TWO OF CHEVRON ............................................. 845
V. TAXPAYERS SHOULD NOT BE FORCED TO CHALLENGE PROCEDURALLY DEFICIENT REGULATIONS THROUGH AN APA CHALLENGE ............. 851

* J.D., University of Akron, 2011. M.S. Taxation, University of Akron, 2011. B.A. Journalism, Duquesne University, 2004. Nicole will be pursuing her LL.M. in Taxation at Georgetown University Law Center commencing in August, 2012. I would like to thank Professor Jane Moriarty for inspiring and advising me in the publication of this article.
I. INTRODUCTION

A litigator—we’ll call him Ira S.—steps into the courtroom. Ira presents his legal argument to the tribunal. “Your honor,” Ira says, “with these facts, and with this law, my client is clearly entitled to judgment in his favor.” The tribunal disagrees. In fact, the tribunal expressly states that the law cited by Ira means precisely the opposite of what Ira claims it means.

Not to be discouraged, Ira, who also happens to be a legislator, writes a new law contradicting the opinion of the trial court. In doing so, Ira informs the country that the trial court was wrong. “Even better,” Ira thinks, “I’ll make this law retroactive. Now my new law will be the law that was in effect at the time I brought my case! That will show the trial court who’s boss. Oh, and I won’t tell anybody about this law until it’s already in effect; wouldn’t want any pesky ‘public uproar’ getting in the way of its passage.”

Ira appeals the decision of the trial court. “Your honor,” Ira says during oral argument, “the new law I have just written clearly applies to the facts of this case. In fact, I wrote this law precisely for that reason. And even though I wrote this law after the case was decided, and even though I did not give the public notice and time to comment on this law, it applies retroactively. Now, you know you have to give deference to my law and enter judgment in my client’s favor.” The appellate court agrees. Ira reigns victorious, and his opponent is left scratching his head, wondering how on earth this decision could be considered fair.

Even setting aside bad puns, in almost every circumstance, the scenario portrayed above would be considered ridiculous. Allowing lawmakers to overturn judicial decisions by enacting retroactively-applicable laws targeted at individual cases and controversies betrays fundamental notions of American justice. However, when one party to the litigation is the Internal Revenue Service

1. The author of this article should not be held responsible for her admittedly bad tax-related sense of humor. Rather, she fully blames her law degree and Masters of Science in taxation for this dilemma.

2. See generally U.S. CONST. art. III, § 2 (instilling the judicial branch with the power to decide individual cases and controversies); see also Marbury v. Madison, 5 U.S. 137, 177 (1803) (“It is emphatically the province and duty of the judicial department to say what the law is.”).
("IRS"), this scenario is not only hypothetically plausible—it has actually been accepted by multiple circuit courts.

Granted, neither the Department of the Treasury nor the IRS are "legislators" per se; rather, these governmental entities fall under the ambit of the executive branch. However, these administrative agencies undoubtedly possess quasi-legislative powers, in that they regularly enact regulations which legally bind taxpayers and provide legal consequences for taxpayers who fail to follow them. Because of these quasi-legislative powers, agencies are bound to follow certain statutory procedures, listed in the Administrative Procedure Act ("APA"), before they can enact and enforce regulations.

Under the seminal case of *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, the United States Supreme Court analyzed the circumstances in which a court is compelled to grant deference to administrative regulations. The two-part test announced in *Chevron* holds that if (1) Congress has not directly spoken to the statutory question at issue and (2) the agency's interpretation is based on a permissible construction of the statute, then courts must give deference to the agency's interpretation. This mandatory deference (known universally as "Chevron deference") is afforded to only those regulations which carry the force of law and are promulgated pursuant to Congressional authority. Unquestionably, the issue of whether a regulation has been properly enacted under the APA and the issue of whether a regulation is entitled to deference under *Chevron*, are interrelated; as of yet, however, the United States Supreme Court has not decisively concluded whether an APA-noncompliant regulation should be afforded mandatory *Chevron* deference.

---

3. The federal government is a party to all federal tax litigation. In the United States Tax Court, IRS attorneys are assigned to litigate the cases. I.R.C. § 7452 (2006). In Article III courts, the government is represented by Department of Justice Tax Division attorneys. 28 U.S.C. § 516 (2006).
4. See infra notes 20-27.
5. U.S. CONST. art. II, § 2, cl. 1.
11. The United States Supreme Court has mentioned APA compliance in multiple opinions, however, stating that the fact that a regulation was promulgated via notice-and-comment is a "significant sign" that such regulation should be afforded judicial deference. *See, e.g.*, Mayo Found. for Med. Educ. & Research v. United States, 131 S. Ct. 704, 714.
This Article thus examines the interplay between administrative procedure under the APA and judicial deference to Treasury regulations. As explained infra, in a very general sense, administrative agencies should issue binding regulations only after a notice and comment period during which the public has an opportunity to comment upon, raise objections to, or express acquiescence with, an agency's proposed regulations. One of the pertinent exceptions to the APA's mandate of notice-and-comment applies when an agency issues interpretive, rather than legislative, rules. The treasury, when issuing regulations affecting the administration of the Internal Revenue Code (“I.R.C.”), has consistently claimed that the APA’s rulemaking mandates do not apply, because its regulations are interpretive in nature.


12. 5 U.S.C. § 553(b)-(d). The APA provides, in pertinent part:
(b) General notice of proposed rule making shall be published in the Federal Register, unless persons subject thereto are named and either personally served or otherwise have actual notice thereof in accordance with law. The notice shall include—
(1) a statement of the time, place, and nature of public rule making proceedings;
(2) reference to the legal authority under which the rule is proposed; and
(3) either the terms or substance of the proposed rule or a description of the subjects and issues involved.

(c) After notice required by this section, the agency shall give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity for oral presentation. After consideration of the relevant matter presented, the agency shall incorporate in the rules adopted a concise general statement of their basis and purpose. When rules are required by statute to be made on the record after opportunity for an agency hearing, sections 556 and 557 of this title 15 U.S.C. §§ 556-571 apply instead of this subsection.
(d) The required publication or service of a substantive rule shall be made not less than 30 days before its effective date, except—
(1) a substantive rule which grants or recognizes an exemption or relieves a restriction;
(2) interpretative rules and statements of policy; or
(3) as otherwise provided by the agency for good cause found and published with the rule.

13. Id. § 553(b)(A)-(B). It states as follows:
Except when notice or hearing is required by statute, this subsection does not apply—
(A) to interpretative rules, general statements of policy, or rules of agency organization, procedure, or practice; or
(B) when the agency for good cause finds (and incorporates the finding and a brief statement of reasons therefor in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest.

14. See Internal Revenue Manual, Part 32. Published Guidance and Other Guidance to Taxpayers, Chapter 1. Chief Counsel Regulation Handbook, Section 5. Required Format for Regulations, Administrative Procedure Act, INTERNAL REVENUE SERV., 32.1.5.4.7.5.1 (Sept. 30, 2011), http://www.irs.gov/irm/part32/irm_32-001-005.html (stipulating that interpretative rules are not subject to the provisions of 5 U.S.C. § 553(b), (c), and (d)). Although most IRS/Treasury regulations are interpretive, and therefore not subject to these provisions of
In the same breath, the Treasury expects the judiciary to afford such regulations *Chevron* deference. The problem with such an expectation is that, in order to be afforded judicial deference, administrative regulations must be issued pursuant to Congressional authority and carry the force of law.\textsuperscript{15} Not surprisingly, the IRS claims that, for purposes of the judicial deference analysis, Treasury regulations do carry the force of law.\textsuperscript{16} Thus, the quandary arises—how can the Treasury claim that its regulations are interpretive and thereby avoid the strictures of the APA, which are designed to foster public discourse, and at the same time claim that its regulations carry the force of law, and consequently, must be granted deference by the judiciary? This Article proposes that it should not; a choice between the two options must be made by the Treasury and the IRS.

This issue carries important implications in the current field of tax controversy. The Treasury and IRS recently received an immense boost from the United States Supreme Court when it decided *Mayo Foundation for Medical Education & Research v. United States*.\textsuperscript{17} The Court essentially held in *Mayo* that Treasury regulations are no different from any other agency’s regulations and should be afforded *Chevron* deference.\textsuperscript{18} The *Mayo* Court issued this opinion without addressing the Treasury’s lax compliance with the APA.\textsuperscript{19} In addition, numerous cases have recently come before the Tax Court and the circuits addressing, albeit tangentially, the ability of the Treasury to issue APA-violative, litigation-directed regulations which have a retroactive effect.\textsuperscript{20}

---

\textsuperscript{15} Id. at § 32.1.1.2.8.

\textsuperscript{16} Id. at 714.

\textsuperscript{17} Id. at 704.

\textsuperscript{18} Id. at 713-14.

\textsuperscript{19} In fact, the *Mayo* Court pointed out multiple times that the Treasury regulations at issue were issued with notice-and-comment. Id. at 714. The Court stated that “notice-and-comment procedures [are] again a consideration identified in our precedents as a ‘significant’ sign that a rule merits *Chevron* deference.” Id. (internal citations omitted). The fact that the Treasury quite often fails to issue regulations with notice-and-comment, however, was not addressed by the Court.

\textsuperscript{20} See *Home Concrete & Supply, LLC v. United States*, 634 F.3d 249 (4th Cir. 2011), aff’d, 132 S. Ct. 1836 (2012); *Intermountain Ins. Serv. of Vail, Ltd. Liab. Co. v. Comm’r*, 650
In this line of cases, explored at length in this Article, the trial courts repeatedly held that, pursuant to Supreme Court precedent, a three year statute of limitations should be used in cases where the IRS is challenging a taxpayer's understatement of taxes due to "overstated basis" in the taxpayer's property. The government, on the other hand, argued that a six year statute of limitations should apply in this scenario. After losing multiple times at the tax and district court level, the Treasury implemented a regulation (without notice-and-comment), which had the effect of overruling the lower court's opinion and bolstering the government's argument. The IRS and/or the Department of Justice ("DOJ") then appealed the lower courts' rulings and cited the new regulation in support, obtaining mixed results at the appellate level depending on whether or not the Circuits chose to grant the new regulation Chevron deference.

Predictably, this line of cases has made its way to the United States Supreme Court. In Home Concrete & Supply, LLC v. United States, the Court had the opportunity, but was not required, to address whether the APA-noncompliant regulation should be afforded deference under Chevron. As explained infra, the Court resolved Home Concrete at Chevron step one, and thus,


21. In other words, the tax court and district courts.
23. "Overstated basis," on a simplistic level, means that a taxpayer has overstated the amount it cost him to acquire the property. See I.R.C. §§ 1011(a), 1016(a) (2006). "Gain" for purposes of taxation is generally computed by subtracting a taxpayer's basis in his property from the amount he received upon disposition of that property. See I.R.C. § 1001(a). Thus, where a taxpayer has overstated the amount of his basis in an item of property, the gain he reports when he disposes of that property will correspondingly be less than if he had reported the correct amount of basis. In all of the cases listed in note 20, supra, the taxpayer had prevailed at the trial court level on the issue of whether a three year or six year statute of limitations should be used when the case involved a tax deficiency stemming from an overstated basis.
24. Which statute of limitations should apply is a question of statutory interpretation, explained in detail in the text accompany notes 246 through 258, infra.
did not determine whether the regulation’s non-compliance with the APA would have affected its legitimacy. This Article agrees with the Mayo Court’s determination that Chevron is the appropriate framework for analyzing all Treasury regulations, including the regulation at issue in Home Concrete. However, under Chevron step two, courts must consider whether regulations have been issued with or without notice-and-comment and for the express purpose of influencing litigation. Thus, Mayo should not be read in such a manner that all Treasury regulations shall be afforded mandatory Chevron deference simply because the Treasury chose to enact a regulation interpreting an ambiguous statute. This analysis ignores the fact that the Chevron test is a two-step process. When an agency has not even attempted to comply with the APA when issuing a regulation, then this Article proposes that step two of Chevron has not been satisfied.

Part II of this essay explains the background of the APA, and compares rulemaking under the APA to the traditional method of Treasury and IRS rulemaking. Part III explores the history of judicial deference to agency regulations, starting with pre-Chevron doctrine and ending with the current jurisprudential landscape. Part IV of this Article proposes that, in light of the importance of the APA and recent doctrinal developments, when an agency has failed to meet the rulemaking requirements of the APA, its regulations fail under Chevron step two and should not be granted mandatory deference. Part V addresses the (lack of) feasibility of

29. Other commentators have argued that Chevron is not the appropriate starting point for treasury regulations that have been issued without notice-and-comment. See, e.g., Andrew Pruitt, Judicial Deference to Retroactive Interpretive Treasury Regulations, 79 GEO. WASH. L. REV. 1558 (2011) (advocating the application of a National Muffler-based analysis). However, given the Supreme Court’s recent decision in Mayo and considering the familiarity of the judiciary with the Chevron doctrine, it is this author’s opinion that disregarding Chevron entirely is too radical an approach and does not maintain fidelity to the doctrinal guidelines of judicial deference.
31. Contrary to the opinions of some commentators, an agency-favorable finding under Chevron step one does not equate to an automatic victory for the agency. See infra note 345 and accompanying text and notes 344-46 and accompanying text. Courts still have discretion to hold that an agency’s interpretation of a statute is arbitrary, capricious, and unreasonable. See infra note 346 and accompanying text.
32. See infra notes 36 through 122 and accompanying text.
33. See infra notes 123 through 330 and accompanying text.
34. See infra notes 331 through 356 and accompanying text.
taxpayers' raising pre-enforcement APA challenges rather than raising a judicial deference argument post-enforcement.\textsuperscript{35}

II. THE BACKGROUND OF THE APA AND IRS RULEMAKING

Separation of powers is one of the fundamental tenets of American government.\textsuperscript{36} However, while the Constitution purports to separate the federal government into three discrete and identifiable branches—\textsuperscript{37} which any avid watcher of Schoolhouse Rock\textsuperscript{38} can recite without hesitation—administrative agencies have long been an additional player in the game of federal governance.\textsuperscript{39} Agencies, in a way, muddle the traditional form of government by combining, rather than separating powers.\textsuperscript{40} However, while administrative agencies, as opposed to the President, Congress, and courts, are not expressly authorized in the Constitution,\textsuperscript{41} their presence is justified by the necessity to federally regulate areas

\begin{itemize}
  \item \textsuperscript{35} See infra notes 357 through 386 and accompanying text.
  \item \textsuperscript{36} The Federalist No. 51 (James Madison); see also Ariz. Christian Sch. Tuition Org. v. Winn, 131 S. Ct. 1436, 1441 (2011) ("The concept and operation of the separation of powers in our National Government have their principle foundations in the first three Articles of the Constitution.").
  \item \textsuperscript{37} See generally U.S. Const. arts. I, II, III.
  \item \textsuperscript{38} Lynn Ahrens, Schoolhouse Rock: Three Ring Government, SCHOOLHOUSE ROCK (1979), www.schoolhouserock.tv/ThreeRing.html. One could certainly argue that the song’s comparison of the U.S. government to a three-ring circus is entirely apropos. While an article expounding upon that comparison must be saved for another day, the relevant verses go as follows:
    Gonna have a three-ring circus someday, People will say it’s a fine one, son. Gonna have a three-ring circus someday, People will come from miles around. Lions, tigers, acrobats, and jugglers and clowns galore, Tightrope walkers, pony riders, elephants, and so much more...
    Guess I got the idea right here at school. Felt like a fool when they called my name, Talkin’ about the government and how it’s arranged, Divided in three like a circus. Ring one, Executive, Two is Legislative, that’s Congress. Ring three, Judiciary. See it’s kind of like my circus, circus.
  \item \textsuperscript{39} James Q. Wilson, The Rise of the Bureaucratic State, 41 PUB. INT. 77, 78 (1975).
  \item \textsuperscript{40} See Steven J. Cann, Administrative Law 8 (4th ed. 2006). This concentration of power contrasts with the oft-stated purpose of tripartite government—that is, to "[diffuse] power the better to secure liberty." Youngstown Sheet & Tube Co. v. Sawyer, 343 U.S. 579, 635 (1952) (Jackson, J., concurring).
  \item \textsuperscript{41} Gary Lawson, The Rise and Rise of the Administrative State, 107 HARV. L. REV. 1231 (1994). Professor Lawson argues that the post-New Deal administrative state is at variance with the Constitution’s original meaning, in part because “those agencies typically concentrate legislative, executive, and judicial functions in the same institution, in simultaneous contravention of Articles I, II, and III.” Id. at 1233.
\end{itemize}
that the traditional tripartite government is ill-equipped to govern.\textsuperscript{42}

Thus, despite the lack of textual authorization vis-à-vis the Constitution, agencies quickly found their way into American government, and their constitutionality has been repeatedly upheld by the Supreme Court.\textsuperscript{43} At the outset of America’s formation, however, the administrative state was quite small; only three administrative departments existed during the presidency of George Washington.\textsuperscript{44} Agencies increased in number throughout the industrial revolution.\textsuperscript{45} In 1887, Congress created the first major federal regulatory body, the Interstate Commerce Commission, which was granted discretionary authority to issue binding decisions on the railroad industry.\textsuperscript{46}

Though their numbers were steadily increasing, until roughly the 1930s, agencies did not possess the authority to make their own policy decisions, but were viewed merely as conduits for enforcing the goals of the legislature.\textsuperscript{47} However, the way agencies would be viewed and allowed to function changed dramatically

\textsuperscript{42} Jeffrey E. Shuren, The Modern Regulatory Administrative State: A Response to Changing Circumstances, 38 HARV. J. ON LEGIS. 291 (2001). Administrative agencies typically are charged with regulating areas that are highly specialized or technical. Id. at 296. Such agencies include the Environmental Protection Agency, the Occupational Health and Safety Administration, and the Food and Drug Administration. Id. While environmental concerns, workplace safety issues, and the sale of healthy food and prescription drugs are areas that the federal government can and should regulate, the ability of politicians who do not necessarily have a background in such areas to implement regulatory policies is low. See id. at 298. Agencies, composed of members who possess specialized knowledge and training in their respective fields, are better equipped to regulate these areas and respond to changing circumstances. Id.


\textsuperscript{44} KENNETH F. WARREN, ADMINISTRATIVE LAW IN THE POLITICAL SYSTEM 39 (1997). These administrative bodies were the Department of State, the Department of War, and the agency which is the subject of critique in this article, the Department of Treasury. Id.

\textsuperscript{45} Wilson, supra note 39, at 77. By 1881, there were 95,000 civilian officers, as compared with only 3000 during the Federalist period of the late 18th and early 19th centuries. Id.

\textsuperscript{46} Wilson, supra note 39, at 94. See also Interstate Commerce Act, ch. 104, 24 Stat. 379 (1887) (codified as amended in scattered sections of 49 U.S.C.).

\textsuperscript{47} See Kevin W. Saunders, Interpretive Rules with Legislative Effect: An Analysis and a Proposal for Public Participation, 1986 DUKE L.J. 346, 351 (1986). Prior to 1932, it was understood that Congress could not delegate legislative power; thus, the ability of agencies themselves to make legislative rules was weak to non-existent. Id. See also United States v. Shreveport Grain & Elevator Co., 287 U.S. 77, 85 (1932) (“That the legislative power of Congress cannot be delegated is, of course, clear.”). However, by 1940, the Supreme Court had changed its course and overruled the non-delegation doctrine, opening the doors for legislative rulemaking by agencies. Sunshine Anthracite Coal v. Adkins, 310 U.S. 381, 398 (1940) (“Delegation by Congress has long been recognized as necessary in order that the exertion of legislative power does not become a futility.”).
with the implementation of President Franklin D. Roosevelt's New Deal.\textsuperscript{48} The Roosevelt administration not only allowed agencies to implement the policies of Congress, but also entrusted administrative agencies with their own policy-making functions.\textsuperscript{49} Agencies were permitted to self-regulate, in order to foster economic stability.\textsuperscript{50} During the New Deal era, it was emphasized that administrative agencies were the experts in the field they represented.\textsuperscript{51} This is a concept that has persisted into the twenty-first century.

The utter necessity of administrative agencies—to implement legislation, create and enforce policy objectives, undertake studies in varied and sometimes highly technical fields, and so on—cannot be understated.\textsuperscript{52} However, with the increased power that agencies began to possess beginning in the 1930s and continuing to the present day comes the potential that such power will be abused.\textsuperscript{53} Moreover, on a fundamental level, the agencies needed procedural checks and balances, in order to imbibe administrative rulemaking with the same legitimacy afforded to legislative lawmaking.\textsuperscript{54} Thus, in an attempt to proscribe legitimate regulatory procedures and protect the citizenry from potential abuse, Congress enacted the APA in 1946.\textsuperscript{55}

\begin{flushright}

\textsuperscript{49} Shuren, supra note 42, at 295-96. Prior to the New Deal, the courts along with many political leaders agreed that agencies should possess a limited scope of power. WARREN, supra note 44, at 39.

\textsuperscript{50} MARC ALLEN EISNER, REGULATORY POLITICS IN TRANSITION 89 (1993).

\textsuperscript{51} BRUCE ACKERMAN & WILLIAM HASSLER, CLEAN COAL/DIRTY AIR 12 (1981).

\textsuperscript{52} K. DAVIS, ADMINISTRATIVE LAW TREATISE § 3:3, at 157 (2d ed. 1978) ("The kind of government we have developed is impossible except through delegation with meaningful standards . . . ."); see also Brian Cook, The Representative Function of Bureaucracy: Public Administration in Constitutive Perspective, 23 ADMIN. & SOC'Y 4, 107 (1992) (discussing the necessity of a bureaucracy to administer many of the tasks fundamental to running a nation).

\textsuperscript{53} COMM. ON THE JUDICIARY, ADMINISTRATIVE PROCEDURE ACT: LEGISLATIVE HISTORY, 79TH CONGRESS, 1944-46, at III (1946) [hereinafter APA: LEGISLATIVE HISTORY].

\textsuperscript{54} See generally BERNARD SCHWARTZ, ADMINISTRATIVE LAW § 4.12 (3d ed. 1991).

\textsuperscript{55} Administrative Procedure Act, 5 U.S.C. §§ 551-59 (2006); see also APA: LEGISLATIVE HISTORY, supra note 53, at 350 (Speaking to the abuse potential, Statesman Elihu Root opined, "[f]et the powers that are committed to these regulating agencies, and which they must have to do their work, carry with them great and dangerous opportunities of oppression and wrong. If we are to continue a government of limited powers these agencies of regulation must themselves be regulated."])
A. The Basics of APA Rulemaking

The APA was enacted in keeping with the fundamental tripartite system of American democracy. Agencies, in effect, merge the three branches of government. Agencies generally fall within the ambit of the executive branch; however, they function as legislatures when they enact regulations that are binding upon citizens and function as courts when they impose sanctions or penalties upon citizens who violate such regulations. Under the traditional executive-legislative-judicial notion of governance, checks and balances are effectuated when each branch is both subject to the control of and can exercise review over the other branches. Because an administrative agency inherently possesses the power of each governmental branch and thus is not subject to the same checks-and-balances monitoring, oversight must be provided in some other way.

Thus, the APA employs three procedural devices as a substitute for traditional checks and balances: public information, administrative operation, and judicial review. The public information requirement demands that agencies disclose information about their organizational structure and procedures, along with publishing "substantive and interpretive rules which they have framed for the guidance of the public." The judicial review element "prescribes . . . how far the courts may go in examining into a given case." Most relevant for purposes of this Article are the APA's requirements relative to administrative operation—codified at 5 U.S.C. § 553.

56. APA: LEGISLATIVE HISTORY, supra note 53, at III.
57. See CANN, supra note 40.
58. U.S. CONST. art. II, § 2. However, statutes can also create so-called "independent" agencies whose heads are not appointed by the President. See, e.g., 15 U.S.C. § 41 (1914) (creating the Federal Trade Commission and providing for the nomination of agency officers).
61. See Cass R. Sunstein, Factions, Self-Interest, and the APA: Four Lessons Since 1946, 72 VA. L. REV. 271, 271 (1986) ("In attempting to control administrative processes, the drafters of the APA responded to two quite general constitutional themes . . . . The first concerns the usurpation of government by powerful private groups. The second involves the danger of self-interested representation: the pursuit by political actors of interests that diverge from those of the citizenry.").
63. Id.
64. Id.
APA § 553 mandates that agencies submit notices of proposed regulations and allow interested parties to submit comments in lieu of the traditional congressional hearing that would otherwise be held during the legislative process. The process outlined in § 553 functions as a substitute for a legislative hearing and is designed to encourage public participation in agency rulemaking. This integral framework of the APA is designed to ensure that agencies function in essentially the same manner as legislatures when performing legislative functions—they develop a rule, submit it for public comment, entertain and evaluate the comments submitted by the citizenry, and only then do they bind the public to the regulation.

The procedures an agency must follow when issuing a rule are strictly defined in the statute. First, the agency must publish a public notice of its proposed rulemaking in the Federal Register. Second, the agency must allow the public to submit comments on the proposed rule. Once the agency has considered the comments submitted by the public, it is then permitted to issue a final rule and must include a “concise general statement of [the rule's] basis and purpose.” The agency then republishes the rule in the Federal Register, and after a period of thirty days, the rule can become effective. This collective process is known as “notice-and-comment rulemaking.”

Likewise, the situations in which agencies may be excused from notice-and-comment rulemaking are limited and defined. The four principal exceptions to the general notice-and-comment requirements are: interpretive rules, procedural rules, policy statements, and good cause. The APA does not define interpretive rules, pro-

---

66. Kristin E. Hickman, Coloring Outside the Lines: Examining Treasury's (Lack of) Compliance with the Administrative Procedure Act Rulemaking Requirements, 82 NOTRE DAME L. REV. 1727, 1728 (2007); see also Am. Hosp Ass'n v. Bowen, 834 F.2d 1037, 1044 (1987) (noting that notice-and-comment rulemaking “reintroduce[s] public participation and fairness to affected parties after governmental authority has been delegated to unrepresentative agencies.”).
67. 5 U.S.C. § 553.
68. Id. § 553(b).
69. Id. § 553(c).
70. Id.
71. Id. § 553(d).
72. See Hickman, supra note 66, at 1734.
73. 5 U.S.C. § 553(b). Other exclusions do exist, but are not relevant for purposes of this Article. See, e.g., 5 U.S.C. § 553(a) (providing an exception for military/foreign affairs regulations).
Judicial Deference

cedural rules, or policy statements. The good cause exception is permitted when notice-and-comment would be “impracticable, unnecessary, or contrary to the public intent.” Any agency asserting the good cause exception must state that it is doing so and explain its reasoning for such assertion when issuing the final version of the regulation.

Violating the procedural mandates of the APA should not—and generally does not—come without consequence. APA § 704 provides a cause of action to challenge “final agency action,” including issuing temporary and final regulations. Under § 706 of the APA, reviewing courts are given the power to determine the applicability of the terms of an agency’s action. This provision also demands that a reviewing court “hold unlawful and set aside agency action, findings, and conclusions found to be . . . without observance of procedure required by law . . . .” Courts have the power to declare regulations invalid for failure to abide by the APA and may enjoin agencies from making decisions based upon such non-compliant regulations.

Thus far, the road from promulgation to enforcement seems pretty clear. An agency follows the APA’s mandates, and the rule can be enforced. An agency fails to do so, and the courts can strike that rule down. However, from both a doctrinal and a practical perspective, denying judicial deference to an APA-noncompliant regulation is not so simple. To invalidate a regulation based upon

---

74. See Hickman, supra note 66, at 1734. As such, courts have predictably been inconsistent when applying these exceptions. Id. citing Robert A. Anthony, "Interpretive" Rules, "Legislative" Rules and "Spurious" Rules: Lifting the Smog, 8 ADMIN. L. REV. AM. U. 1, 2-6 (1994)). However, these types of exceptions generally apply to rules that, while providing guidance, do not bind the public, the government, or the courts. See RICHARD J. PIERCE, JR., 1 ADMINISTRATIVE LAW TREATISE § 6.4 (5th ed. 2010).

75. 5 U.S.C. § 553(b)(B).

76. Id. Section 553(d)(3) also allows an agency to invoke good cause to avoid the thirty day advance publication period for final rules. Id. Courts also require an agency that is asserting good cause as an exemption from APA compliance to do so expressly and contemporaneously with the promulgation of the regulation. See Buschmann v. Schweiker, 676 F.2d 352, 356-57 (9th Cir. 1982).

77. See JAMES T. O’REILLY, ADMINISTRATIVE RULEMAKING § 13:1 (2d ed. 2007). In fact, Treasury regulations are somewhat of an anomaly in administrative law in that their regulations are rarely challenged under the APA. APA challenges to other administrative regulations are rather common. See id. (“Pre-enforcement injunction actions are sometimes begun the very day an agency rule is promulgated . . . .”). The reasons for this discrepancy between tax and non-tax APA challenges are explained more fully in section V, infra.

78. 5 U.S.C. § 704.

79. Id. § 706.

80. Id. § 706(2)(D).

81. See Sacora v. Thomas, 628 F.3d 1059, 1065 (9th Cir. 2010).
an APA violation, the regulation must actually be challenged in a proceeding, which, for reasons explained infra, is not always likely to occur.\textsuperscript{82} It is unclear what the courts are to do when an agency doesn't play by the rules of rulemaking and nobody brings an APA challenge. When the agency later relies upon these APA-violative regulations in a civil proceeding, must the court grant these regulations deference pursuant to 

Chevron, since the regulations do carry the force of law? Or should the judiciary be given leeway to decide that, even if the preliminary doctrinal requirements of judicial deference are met, it can nonetheless refuse to defer? These questions are answered in Section III, infra.

B. The Treasury's Failure to Play by the Rules of Rulemaking

One might expect that the Treasury, one of the oldest—and arguably the most powerful\textsuperscript{83}—administrative agencies, would be well-aware of and abide by the strictures of the APA. The relationship between the Treasury's rulemaking process and the APA is not exactly symbiotic, however. The I.R.C. grants the Department of Treasury broad interpretive authority over the Code's provisions. This authority is conveyed in one of two ways\textsuperscript{84}—either

\begin{itemize}
\item[82.] See infra section V.
\item[83.] The Treasury Department was established by Congress in 1789. Act of Sept. 2, 1789, ch. 12, § 1, 1 Stat. 65. Unlike many more niche agencies, the rules set forth and the actions taken by the Treasury affect virtually every American. According to the Department's web page, the Treasury "is the executive agency responsible for promoting economic prosperity and ensuring the financial security of the United States." Duties & Functions of the U.S. Department of the Treasury, U.S. TREASURY, www.treasury.gov/about/role-of-treasury/pages/default.aspx (last visited Nov. 14, 2011). The basic functions of the Treasury include: managing federal finances, collecting taxes owed to the United States and paying the bills of the United States, enforcing federal finance and tax laws, and investigating and prosecuting tax evaders, counterfeiters, and forgers. Id. The IRS is one of the operating bureaus included in the Treasury Department. Id. Considering that the IRS has the ability to take money and property from Americans without a prior hearing or a court order, see I.R.C. § 6331 (2006), the power of the Treasury Department cannot be overstated. This centralized accumulation of power—i.e., the power of one agency to promulgate, execute, and adjudicate rules—is the precise reason the APA was enacted. APA: LEGISLATIVE HISTORY, supra note 53, at 350.
\item[84.] This Article only addresses the authority of the Treasury to issue binding regulations. The Treasury and the IRS, in fact, have much broader interpretive authority. The IRS also issues official, published guidance known as Revenue Rulings, which explain how the IRS interprets the law as applied to a given set of facts. Treas. Reg. § 601.601(d)(2)(i)(a) (2011). Furthermore, the IRS may issue a Private Letter Ruling ("PLR") when requested by a taxpayer under specified circumstances, informing that taxpayer how the IRS would interpret that taxpayer's situation. Rev. Proc. 2012-1, 2012-1 I.R.B. 1. The level of deference or judicial respect that should be afforded to such less formal, though frequently used, forms of guidance issued by the IRS is beyond the scope of this Article.
\end{itemize}
through a specific authorization to promulgate regulations\textsuperscript{85} or pursuant to the Treasury's general rulemaking authority.\textsuperscript{86} The I.R.C. contains several hundred specific authority grants.\textsuperscript{87} These specific authority grants are identified by Congress and direct the Treasury to fill in identified statutory gaps.\textsuperscript{88} Regulations promulgated pursuant to these specific authority grants have traditionally been denoted as "legislative" regulations.\textsuperscript{89}

In addition, the I.R.C. grants the Treasury general rulemaking authority to develop "all needful rules and regulations for the enforcement of" the Code.\textsuperscript{90} These rules are known as "interpretive" regulations.\textsuperscript{91} The regulations, which were at play in \textit{Home Concrete} and are the subject of this Article, are general authority regulations.\textsuperscript{92} Despite their monikers, legislative and interpretive regulations are equally important in the eyes of taxpayers.\textsuperscript{93}

Treasury regulations are further classified according to their finality. The Treasury has the authority to issue proposed, temporary, and final regulations. Proposed regulations do not carry the force of law\textsuperscript{94}, whereas temporary and final regulations are binding when issued.\textsuperscript{95} The major distinction between temporary and final

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{85} See, e.g., I.R.C. § 1502 (2006).
\item \textsuperscript{86} Id. § 7805(a).
\item \textsuperscript{87} See, e.g., id. § 6103(q) (2012); id. § 7502(c)(2) (2006).
\item \textsuperscript{88} For example, I.R.C. § 6103(q) directs the Secretary of Treasury "to prescribe such other regulations as are necessary to carry out the provisions of this section." This language is representative of "specific authority" contained in the I.R.C.
\item \textsuperscript{89} See Mark E. Berg, \textit{Judicial Deference to Tax Regulations: A Reconsideration in Light of National Cable, Swallows Holding, and Other Developments}, 61 TAX LAW. 481, 485-86 (2008).
\item \textsuperscript{90} I.R.C. § 7805(a).
\item \textsuperscript{91} See Berg, \textit{supra} note 89, at 485-86.
\item \textsuperscript{92} Treas. Reg. § 301.6501(e)-1 (2011) (authority applicable to entire part: 26 U.S.C. § 7805).
\item \textsuperscript{93} If you violate either type of regulation and the IRS catches you, you are in for one unhappy audit. Even an unintentional failure to adhere to the Treasury's "rules and regulations" will subject a taxpayer to penalties. I.R.C. § 6662(a)-(b) (the "accuracy-related penalty"). The Treasury's regulations interpreting the accuracy-related penalty do not distinguish between specific and general authority regulations in circumscribing § 6662's applicability. Treas. Reg. § 1.6662-3 (2011). Thus, both types of regulations are binding on taxpayers, and violating either type of regulation subjects a taxpayer to equal concomitant penalties.
\item \textsuperscript{94} See S. Cent. United Food & Commercial Workers Unions & Emp'r's Health & Welfare Trust v. Appletree Mkts., Inc. (\textit{In re Appletree Mkts, Inc.}), 19 F.3d 969, 973 (5th Cir. 1994) (noting that proposed regulations are entitled to no force and effect until finalized).
\item \textsuperscript{95} Hickman, \textit{supra} note 66, at 1759 ("[T]he Treasury and the IRS treat temporary Treasury regulations as legally binding on taxpayers as well as the government."). See also Redlark v. Comm'r, 141 F.3d 936, 939 (9th Cir. 1998) (deferring to temporary regulations under \textit{Chevron}).
\end{itemize}
\end{footnotesize}
The distinction between legislative and interpretive regulations in the tax context can be misleading, especially when applied to the judicial deference doctrine, if not properly examined. Interpretive Treasury regulations do not carry any less weight than do legislative regulations. In a practical sense, both types of regulations have the same effect. The only distinction is the source of authority under which the regulation was promulgated. Critically, because both types of regulations are "rules" under the APA, the Treasury is bound to follow APA notice-and-comment regulations is that temporary regulations expire three years after being issued.

---

96. I.R.C. § 7805(e)(2). Other than their respective life-spans, temporary and final regulations have virtually identical practical effects. The Treasury's own regulations define both temporary and final regulations issued under the I.R.C. as "rules or regulations" for purposes of the Code's penalty provisions. Treas. Reg. §§ 1.6662-3(b)(2), 1.6694-3(e) (2011); see also I.R.C. §§ 6662(a)-(b)(1), 6662(c), 6694(b). The government, taxpayers, and the courts all agree that temporary and final Treasury regulations are equally binding on both the government and taxpayers. See, e.g., Estate of Gerson v. Comm'r, 507 F.3d 435, 438 (6th Cir. 2007); Irving Salem, Ellen P. Aprill & Linda Galler, ABA Section of Taxation Re- port of the Task Force on Judicial Deference, 57 TAX L. 717, 735 (2004) ("Unlike proposed regulations, temporary regulations are effective when they initially appear in the Federal Register, thus providing immediate and binding guidance to taxpayers.").

97. Most importantly, the interpretive versus legislative distinction in the I.R.C. is not the same as the interpretative versus legislative distinction in the APA. Historically, however, the distinction between legislative and interpretive regulations was very significant, and a brief synopsis of the nature and development of this distinction is in order. Under the now outdated non-delegation doctrine, Congress could not delegate legislative functions to any other branch of government. United States v. Shreveport Grain & Elevator Co., 287 U.S. 77, 85 (1932). Thus, during the time that the non-delegation doctrine was in effect, there was no need for a legislative/interpretive distinction. Regulations could only be interpretive, because agencies could not be delegated the power to make legislative decisions. However, in 1940, the Supreme Court expressly allowed the delegation of legislative decision-making. Sunshine Anthracite Coal Co. v. Adkins, 310 U.S. 381, 398-400 (1940). Pursuant to the demise of the non-delegation doctrine, administrative agencies could then either make legislative (i.e., binding) rules or could issue rules that did not have the force of law but merely explained rights already created by statute. See Saunders, supra note 47, at 350. As explained infra, the formal distinction between legislative and interpretive regulations in the tax context has all but disappeared, because even regulations characterized as "interpretive" have the force and effect of law.

98. Mayo Found. for Med. Educ. & Research v. U.S., 131 S. Ct. 704, 714 (2011) (whether a rule carries the force of law "does not turn on whether Congress's delegation of authority was general or specific").

99. This distinction has been rendered largely irrelevant by Mayo. See infra notes 187-222.

100. Administrative Procedure Act, 5 U.S.C. § 551(4) (2006) (defining a "rule" as "the whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or to describe the organization, procedure, or practice requirements of an agency . . . ."). Rules differ from a "statement of policy," which merely "pronounces existing rights or liabilities." APA: LEGISLATIVE HISTORY, supra note 53, at 197.
procedures when issuing both legislative and interpretive regulations. This, however, the Treasury has been wont to do.

The Treasury's lax compliance with the APA was thoroughly documented in a 2007 empirical study conducted and published by Professor Hickman. Professor Hickman conducted a study of 232 separate regulatory projects for which the Treasury issued Treasury Decisions (“TDs”) and Notices of Proposed Rulemaking (“NPRMs”) in the Federal Register from January 1, 2003 through December 31, 2005. Professor Hickman found that the rulemaking did not comply with the APA ninety-five times, or in 40.9 percent of the total projects studied. Of these ninety-five violations, eighty-four violations consisted of the Treasury issuing binding temporary regulations simultaneously with NPRMs. On eleven additional occasions, final regulations were issued without notice-and-comment altogether.

The issuance of temporary regulations simultaneously with NPRMs defeats the purpose of notice-and-comment rulemaking. Although temporary regulations expire either after three years or when the final regulations are issued, such regulations are binding when issued. The purpose of the APA is to protect affected parties before a rule becomes binding. Thus, this purpose is violated when temporary regulations are issued absent notice-and-comment, even if the agency allows for a period of comment in the interim, between the temporary and final regulations.

102. See Hickman, supra note 66.
103. Id. at 1730.
104. Id. at 1748.
105. Id.
106. Id. at 1749.
107. This issuance of legally-binding temporary regulations without notice-and-comment, along with the simultaneous request for post-promulgation comment, is known as “interim-final rulemaking” and has been heavily criticized as a violation of both the letter and spirit of the APA. See, e.g., Michael Asimow, Interim-Final Rules: Making Haste Slowly, 51 ADMIN. L. REV. 703, 704 (1999). See also Administrative Conference of the United States, Notices, Adoption of Recommendations, 60 Fed. Reg. 43,108, 43,111-12 (Aug. 18, 1995) (“Courts generally have not allowed post-promulgation comment as an alternative to the pre-promulgation notice-and-comment process in situations where no exemption [to APA § 553] is justified.”).
108. See supra note 95. This is akin to Congress enacting a law without holding any type of public hearing or considering any public commentary and then enforcing that law upon the public.
110. Under the APA’s intended scheme, “regulated parties are only bound by regulations on which they have previously had an opportunity to comment.” Kristin E. Hickman, A Problem of Remedy: Responding to Treasury’s (Lack of) Compliance with Administrative Procedure Act Rulemaking Requirements, 76 GEO. WASH. L. REV. 1153, 1160 (2008). To the
Pension of final regulations without any notice-and-comment whatsoever is even more disturbing, because the public never has an opportunity to participate in the rulemaking process.

The Treasury's main excuse for its consistent lack of APA compliance is that the regulations fit within one of the exceptions to APA rulemaking procedures. As noted supra, an agency does not have to follow APA § 553's procedures if the regulation is interpretive or procedural, or if the agency can demonstrate good cause why notice-and-comment rulemaking need not be followed. Professor Hickman found that whether or not the Treasury actually followed the traditional APA steps, the agency disclaimed the applicability of the APA in 92.7% of its projects. In those projects where the Treasury violated the APA by issuing temporary regulations concurrently with NPRMs, the Treasury claimed the good cause exception fifteen times (17.86%), was silent as to applicability three times (3.57%), and expressly disclaimed the APA without giving a reason sixty-six times (78.57%). Where the Treasury issued final regulations without notice-and-comment altogether, the Treasury claimed both the interpretive rule and the procedural rule exceptions one time each (8.33%, respectively), claimed the good cause exception six times (50%), and claimed inapplicability with no reason given four times (33.34%).

The Treasury claims that most of its regulations are interpretive. The basis for such a declaration is questionable at best, however. All Treasury regulations are legislative rules for APA purposes, whether promulgated under specific or general author-
ity.117 Both general and specific authority regulations carry the force of law, affecting taxpayers' rights and obligations118, thereby making such rules "legislative" by definition.119 Moreover, if the Treasury and the IRS are being honest in their assessment of Treasury regulations as interpretive, then one would think they must be foreclosed from arguing that these regulations carry the force of law and are entitled to deference.120 As of now, however, the Treasury has been successful in its argument that, even though many of its regulations are exempt from the APA,121 they are nonetheless entitled to the level of deference only afforded to those regulations that carry the force of law and have been promulgated pursuant to Congressional authority.122

III. THE HISTORY AND CURRENT STATE OF JUDICIAL DEFERENCE TO AGENCY REGULATIONS

Although Chevron123 is universally considered the landmark decision on judicial deference to agency regulations, United States Supreme Court jurisprudence in this area does predate the Chevron case.124 Before Chevron was decided, Skidmore v. Swift & Co.125 controlled federal courts' review of agency rulemaking.126 The Skidmore Court held that agency interpretations were merely persuasive, rather than controlling, and that courts should look to

117. Id. at 1773; see also Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 843-44 (1984) (characterizing a general authority grant as an "implicit" delegation of legislative authority and recognizing that a regulation promulgated pursuant to general authority is equally binding as a specific authority regulation).
120. See United States v. Mead, 533 U.S. 218, 226-27 (2001) (holding that only administrative regulations which carry the force of law are entitled to Chevron deference, with the rest being entitled only to varying levels of respect).
121. Considering that the Treasury disclaimed APA applicability over 90 percent of the time it promulgated a rule, it follows that the Treasury considers almost none of its rules to really be rules, at least for administrative procedure purposes. See Hickman, supra note 66, at 1749.
122. See Mead, 533 U.S. at 226-27.
124. Moreover, Chevron did not wipe the judicial deference slate clean, so to speak, as pre-Chevron cases continued to be cited and utilized post-decision. See infra note 186, which cites cases to show the competing standards of review applied to both tax and non-tax cases after Chevron.
factors such as the validity and consistency of the agency's reasoning when deciding if the agency action deserved deference.\textsuperscript{127} Thus, after \textit{Skidmore}, where "an agency's rule 'flatly contradicted' its prior rule, was of recent vintage, or concerned a non-technical area within the court's expertise, courts were less apt to defer to the rule."\textsuperscript{128}

In the interim between \textit{Skidmore} and \textit{Chevron} came a tax-specific judicial deference case, \textit{National Muffler Dealers Ass'n v. United States}.\textsuperscript{129} Like \textit{Skidmore}, \textit{National Muffler} mandated a context-based approach to the judicial deference analysis, providing that:

In determining whether a particular regulation carries out the congressional mandate in a proper manner, we look to see whether the regulation harmonizes with the plain language of the statute, its origin, and its purpose. A regulation may have particular force if it is a substantially contemporaneous construction of the statute by those presumed to have been aware of its congressional intent. If the regulation dates from a later period, the manner in which it evolved merits inquiry. Other relevant considerations are the length of time the regulation has been in effect, the reliance placed on it, the consistency of the Commissioner's interpretation, and the degree of scrutiny Congress has devoted to the regulation during subsequent re-enactments of the statute.\textsuperscript{130}

Thus, as in \textit{Skidmore}, the Court advised that interpreting courts should look beyond the face of the regulation in determining whether to grant that regulation deference. Post-\textit{Skidmore} and \textit{National Muffler}, courts had wide discretion to overturn agency regulations and interpretations. This all changed, however, with the Court's watershed decision in \textit{Chevron}.

\textsuperscript{127} \textit{Skidmore}, 323 U.S. at 140. In regard to agency decisions, the Court found that: [W]hile not controlling upon the courts by reason of their authority, [agency decisions] do constitute a body of experience and informed judgment to which courts and litigants may properly resort for guidance. The weight of such a judgment in a particular case [depends] upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give power to persuade, if lacking power to control. \textit{Id.}

\textsuperscript{128} Hasen, supra note 126, at 334 (citing Packard Motor Co. v. NLRB, 330 U.S. 485 (1947); Frank Diehl Farms v. Sec'y of Labor, 696 F.2d 1325, 1330 (11th Cir. 1983)).

\textsuperscript{129} Nat'l Muffler Dealers Ass'n, Inc. v. United States, 440 U.S. 472 (1979).

\textsuperscript{130} Nat'l Muffler, 440 U.S. at 477.
A. Transferring Power with the Chevron Two-Step

Similar to the authority granted to the Treasury by the I.R.C. to enact "needful regulations," the Clean Air Act gives the Administrator of the Environmental Protection Agency (EPA) the authority to "prescribe such regulations . . . as are necessary to carry out his functions under" the act. Utilizing the required APA notice-and-comment procedures, the EPA exercised its general authority to promulgate a regulation defining a statutorily-undefined term, "stationary source." After the Reagan administration initiated a "[g]overnment-wide reexamination of regulatory burdens and complexities," however, the EPA reconsidered its definition and again utilized notice-and-comment to adopt a new definition of stationary source. The Natural Resources Defense Council challenged the subsequent interpretation of the term. The District of Columbia Court of Appeals rejected the new regulation and employed its own interpretation of this ambiguous term.

The Supreme Court disagreed with the circuit court's approach to the judicial deference analysis. In so doing, the Chevron Court elucidated a new standard of judicial deference for agency regulations and mandated judicial adherence to agency interpretations so long as such interpretation is reasonable. The Court

---

136. Id. at 841.
139. Id. at 844.
criticized the court of appeals’ approach as substituting its own judgment for that of the agency.\textsuperscript{140}

The upshot of \textit{Chevron} is the famous two-part inquiry now ingrained in administrative law: first, whether the statute being interpreted clearly and unambiguously resolves the issue, and if not, whether the agency’s interpretation of the statute is a permissible one.\textsuperscript{141} \textit{Chevron} is important because it forces courts to essentially take a backseat to agencies in many instances of statutory interpretation.\textsuperscript{142} This is true not only where Congress specifically mandates regulations, but also where Congress implicitly delegates rulemaking authority, by enacting a statute and granting an administrative agency the power to prescribe regulations necessary to carry out the agency’s functions.\textsuperscript{143} Professor Hickman describes the \textit{Chevron} decision as representing “a transfer of interpretive power from the judicial branch to administrative agencies.”\textsuperscript{144}

The \textit{Chevron} Court recognized that interpreting ambiguous statutes necessarily entails making policy judgments.\textsuperscript{145} In the Court’s opinion, it is the administrative agencies, not the courts, which should be making these policy decisions.\textsuperscript{146} The Court explained its rationale as follows:

If Congress has explicitly left a gap for the agency to fill, there is an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation. Such legislative regulations are given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute. Sometimes the legislative delegation to an agency on

\begin{footnotesize}
\begin{enumerate}
\item Id. at 845. (“In light of these well-settled principles it is clear that the Court of Appeals misconceived the nature of its role in reviewing the regulations at issue.”).
\item Id. at 843. Of course, the first prong of \textit{Chevron} existed as a maxim of statutory interpretation even prior to the Court’s decision. When a statute is unambiguous, neither administrative agencies nor courts have the authority to substitute their own interpretations for the plain language of the statute. \textit{Id.} at 843 n.9 (citations omitted) (“If a court, employing traditional tools of statutory construction, ascertains that Congress had an intention on the precise issue at question, that intention is the law and must be given effect.”).
\item Id. at 844 (“A] court may not substitute its own construction of a statutory provision for a reasonable interpretation made by the administrator of an agency.” (emphasis added)).
\item Chevron, 467 U.S. at 844.
\item Chevron, 467 U.S. at 843.
\item Id.
\end{enumerate}
\end{footnotesize}
a particular occasion is implicit rather than explicit. In such a case, a court may not substitute its own construction of a statutory provision for a reasonable interpretation made by the administrator of an agency.\footnote{147}{Id. at 843-44.}

This holding allows for both agency freedom within the scope of permissibility, and further permits agencies to change their minds should a new interpretation be subsequently deemed more favorable.\footnote{148}{This is in contrast to the prior decisions of Skidmore and National Muffler, which looked unfavorably upon an agency's inconsistent interpretations of the same statute. See supra text accompanying notes 125-30.} However, the Court stopped short of mandating deference to all statutory interpretations by agencies. Only where an agency's interpretation is a permissible one is that interpretation afforded judicial deference.\footnote{149}{Chevron, 467 U.S. at 843.}

Under this "permissible" prong, i.e., Chevron step two, an agency interpretation will be upheld so long as it is not arbitrary, capricious, or manifestly contrary to the statute.\footnote{150}{Id. at 844.} Although this language affords powerful deference to administrative rules, Chevron is not a "blank check for administrative fiat."\footnote{151}{See Hickman, supra note 144, at 1553.} Chevron step two still affords courts some, albeit tightly limited, discretion to strike down administrative regulations that are arbitrary or manifestly unreasonable.

Although the Chevron Court did not limit the application of the two-part test to any doctrinal subset of administrative law, both scholars and litigants argued that National Muffler still applied post-Chevron to tax cases.\footnote{152}{See, e.g., Ellen P. Aprill, The Interpretive Voice, 38 LOY. L.A. L. REV. 2081 (2005); John Coverdale, Chevron's Reduced Domain: Judicial Review of Treasury Regulations and Revenue Rulings After Mead, 55 ADMIN. L. REV. 39, 83 (2003) (arguing that the Skidmore standard applies in this context); Noel Cunningham & James Repetti, Textualism and Tax Shelters, 24 VA. TAX REV. 1 (2004) (summarizing the Chevron/Skidmore/National Muffler dispute); Thomas W. Merrill & Kathryn Tongue Watts, Agency Rules with the Force of Law: The Original Convention, 116 HARV. L. REV. 467 (2002) (indicating that the Skidmore standard may apply in the case of interpretive tax regulations); Salem, Aprill & Galler, supra note 96 (arguing in favor of using factors enunciated in National Muffler to assess the validity of interpretive tax regulations); see also Gregg D. Polsky, Can Treasury Overrule the Supreme Court?, 84 B.U. L. REV. 185 (2004) (also noting the dispute among Chevron, Skidmore, and National Muffler).} In other words, the National Muffler proponents argued in favor of tax exceptionalism—i.e., that tax law is different than other areas of administrative law and that Treasury regulations should not necessarily be afforded Chevron
deference. Courts did nothing to clear up this confusion, continuing to cite *National Muffler* in tax decisions even after *Chevron* was decided. In recent years, however, the continued viability of the *National Muffler* multi-factor analysis has arguably been put to rest with the Court’s decisions in *Mead, Brand X,* and *Mayo,* discussed infra.

**B. Administrative Power Reinforced: Post-Chevron Decisions**

1. United States v. Mead Corp.

In the years since *Chevron,* the administrative deference doctrine has been functionally reinforced, while at the same time, the scope of regulations to which deference must be granted has been tightened. The doctrine was strengthened in *United States v. Mead Corp.,* wherein the Court reiterated that granting *Chevron* deference to applicable administrative regulations is not a judgment call, but rather is mandatory. Contemporaneously, the Court made clear that this stringent deference is warranted only for agency interpretations promulgated through the exercise of congressionally delegated authority to bind regulated parties "with the force of law." Thus, as a correlative to *Mead's* reinforcement of *Chevron* deference for legally-binding regulations, *Mead* also advised courts to apply *Chevron* deference judiciously. According to the *Mead* Court, *Chevron* only applies when a court affirmatively finds that Congress implicitly delegated primary interpretive power, and the agency exercised that power in question. This is due to the un-

---


154. The qualifier is inserted because *National Muffler* has not been explicitly overruled, even if it has been so functionally.


156. *Mead,* 533 U.S. at 226.

157. *Id.* at 226-27.

158. *Id.* ("Delegation of such authority may be shown in a variety of ways, as by an agency’s power to engage in adjudication or notice-and-comment rulemaking, or by some other indication of a comparable congressional intent.").
understanding that Congress, at least implicitly, desired that an agency, rather than the courts, be the primary interpreter of a particular statutory scheme.159

For those regulations that fail to meet either the delegation of authority or the exercise of authority prong of Mead, the Court determined that Skidmore respect was the appropriate standard of review to be utilized.160 Unlike Chevron's mandatory deference regime, Skidmore respect affords the courts much more discretion.161 The policy behind Skidmore, the Mead Court found, was similar to the policy behind Chevron.162 Where Congress does not intend that an agency be the primary interpreter of its statutes, but at the same time permits agencies to issue interpretive regulations, the judiciary remains the final arbiter of the law.163 Skidmore respect allows a reviewing court to defer to the agency regulation where sensible, but does not mandate the judicial deference of Chevron.164 Again however, where regulations have been found to carry the force of law, Mead is unequivocal that Chevron deference is required.165

2. National Cable & Telecommunications Ass'n v. Brand X Internet Services

Perhaps the strongest amplification of pro-Chevron deference came with the United States Supreme Court's 2005 decision in National Cable & Telecommunications Ass'n v. Brand X Internet Services.166 Therein, the Court addressed the question of whether the judiciary must defer to agency interpretations that actually contradict a prior judicial construction—i.e., whether Chevron deference or stare decisis should be the prevailing doctrine concerning the enforceability of administrative regulations.167 The Court held that Chevron deference should be utilized and issued an opin-
ion that unqualifiedly favors agency over judicial interpretations of ambiguous statutes.\footnote{Id.}

In \textit{Brand X}, the Court reviewed a Ninth Circuit Court of Appeals decision holding that broadband cable service was properly classified as a “telecommunications service” under the Communications Act of 1934.\footnote{Id. at 973 (citing 47 U.S.C. § 153(44) (1934)).} Although the Federal Communications Commission (“FCC”) had issued regulations determining that broadband cable service was not a telecommunications service,\footnote{Id. at 979 (citing \textit{In re Inquiry Concerning High-Speed Access to the Internet over Cable and Other Facilities}, 17 FCC Rcd. 4798, 4823-24 (2002), \textit{aff'd in part, vacated in part sub nom. Brand X Internet Servs. v. FCC}, 345 F.3d 1120 (9th Cir. 2003), \textit{rev'd sub nom. Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.}, 545 U.S. 967 (2005)).} the Ninth Circuit Court of Appeals chose not to follow the FCC’s interpretation of the statute\footnote{Brand X Internet Servs. v. FCC, 345 F.3d 1120, 1130-31 (9th Cir. 2003), \textit{rev'd sub nom. Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.}, 545 U.S. 967 (2005).} and instead relied on circuit precedent holding that this type of service was a telecommunications service.\footnote{AT&T Corp. v. Portland, 216 F.3d 871, 877-80 (9th Cir. 2000), \textit{rev'g}, 43 F.Supp.2d 1146 (D. Or. 1999).}

The Supreme Court reversed the Ninth Circuit Court of Appeals. In so doing, the Court held that:

A court’s prior judicial construction of a statute trumps an agency construction otherwise entitled to \textit{Chevron} deference only if the prior court holds that its construction follows from the unambiguous terms of the statute and thus leaves no room for agency discretion. This principle follows from \textit{Chevron} itself . . . \textit{Chevron}’s premise is that it is for agencies, not courts, to fill statutory gaps. The better rule is to hold judicial interpretations contained in precedents to the same demanding \textit{Chevron} step one standard that applies if the court is reviewing the agency’s construction on a blank slate: Only a judicial precedent holding that the statute unambiguously forecloses the agency’s interpretation, and therefore contains no gap for the agency to fill, displaces a conflicting agency construction.\footnote{Brand X, 545 U.S. at 982-83.}

\textit{Brand X} is therefore a critical decision in favor of agency primacy. \textit{Brand X} stands for the proposition that even stare decisis
will not stand in the way of agency reinterpretation. So long as the doctrinal mandates of *Chevron* and *Mead* are met, a later interpretation by an agency controls over a prior—and otherwise precedential—decision by a court.

Of course, room still existed for the tax exceptionalism debate after *Mead* and *Brand X*, although this argument was increasingly coming under scrutiny. Neither *Mead* nor *Brand X* addressed Treasury regulations specifically, or the Department's unique dichotomy of legislative and interpretive regulations. The arguments for and against tax exceptionalism in the deference arena were wide and varied, and existed both amongst scholars and practitioners and throughout the courts. Lower federal courts and the Tax Court stated varying opinions as to whether *Chevron* or *National Muffler* articulated the proper standard for judicial deference to Treasury regulations. These courts stated at various points that *National Muffler* was the correct standard, that *Chevron* would apply to all Treasury regulations, and that *Chevron* restates the *National Muffler* analysis, thereby rendering the argument moot.

The circuit courts, in turn, exacerbated the deference dilemma. Prior to 2011, *Chevron* definitely applied to § 7805(a) Treasury regulations in the Sixth Circuit, whereas *National Muffler* was the standard de jure in the Eighth Circuit. Still other courts determined that *Chevron* and *National Muffler* were indistin-

174. *Id.* The Court explained that a contrary rule would “mean that whether an agency’s interpretation of an ambiguous statute is entitled to *Chevron* deference would turn on the order in which the interpretations issue,” and that such a rule would produce anomalous and improper results, because “whether Congress has delegated to an agency the authority to interpret a statute does not depend on the order in which the judicial and administrative constructions occur.” *Id.* at 983.

175. *Id.* at 985.

176. Hickman, *supra* note 144, at 1539-40 (discussing competing applications of the judicial deference doctrine post-*Mead*).

177. See Snowa v. Comm’r, 123 F.3d 190, 197 (4th Cir. 1997) (specific authority regulations given “controlling weight” under *Chevron*, while general authority regulations given “considerable weight” under *National Muffler*); see, e.g., Salem, Aprill & Galler, supra note 96, at 724-25 (recommending *Chevron* deference for specific authority regulations but incorporating the *National Muffler* analysis for general authority regulations).

178. See, e.g., Snowa, 123 F.3d at 197.


183. Snowa, 123 F.3d at 197.
guishable. Scholarly writing was in similar discord, both as to which standard actually applied and which standard was preferable. The United States Supreme Court, until 2011, routinely cited both \textit{Chevron} and \textit{National Muffler} in judicial deference/tax cases, without providing further illumination as to which standard governed the review of tax regulations. Only recently did the Supreme Court seek to finally answer the question of whether \textit{Chevron} should apply in tax cases—and with its decision in \textit{Mayo}, delivered a devastating blow to the tax exceptionalists.

3. Mayo Foundation for Medical Education and Research v. United States

\textit{Mayo} involved judicial review of Treasury regulations interpreting the Federal Insurance Contributions Act ("FICA"), enacted by Congress to collect funds for Social Security. Under the statutory scheme, "students" are exempted from FICA taxes. The Social Security Act contains a corresponding student exception materially identical to the FICA definition. The question presented to the \textit{Mayo} Court was whether doctors who serve as medical residents are properly classified as students for FICA purposes.

\begin{itemize}
\item \textbf{184.} See, e.g., Bankers Life & Cas. Co. v. United States, 142 F.3d 973, 978-83 (7th Cir. 1998) (concluding that, despite some differences, the two standards were virtually indistinguishable); Norwest Corp. v. Comm'r, 69 F.3d 1404, 1408-09 (8th Cir. 1995) (citing both \textit{Chevron} and \textit{National Muffler} as support for deference to Treasury regulations); Cent. Pa. Sav., 104 T.C. at 390-92 (finding the differences between the two standards to be negligible).
\item \textbf{185.} Compare Edward J. Schnee & W. Eugene Seago, \textit{Deference Issues in the Tax Law: Mead Clarifies the Chevron Rule—Or Does It?} 96 J. TAX'N 366, 371-72 (2002) (arguing that general authority Treasury regulations should only be granted a less-than-mandatory degree of deference based on the regulation’s “reasonableness”), \textit{with} Hickman, supra note 144 (addressing the normative and doctrinal cases for applying \textit{Chevron} to all Treasury regulations and rejecting the \textit{National Muffler} alternative).
\item \textbf{188.} Mayo, 131 S. Ct. at 708.
\item \textbf{189.} I.R.C. § 3121(b)(10) (2006). Under this provision, Congress excluded from taxation "service performed in the employ of . . . a school, college, or university . . . if such service is performed by a student who is enrolled and regularly attending classes at such school, college, or university." \textit{Id.}
\item \textbf{191.} Mayo, 131 S. Ct. at 708.
\end{itemize}
Since 1951, the Treasury Department had applied the student exception to exempt from taxation students who work for their schools “as an incident to and for the purpose of pursuing a course of study.” The Treasury had determined whether an individual’s work was incident to his studies on a case-by-case basis until 2005. The Social Security Administration (“SSA”) had adopted a similar approach in its regulations interpreting the corresponding exception to the Social Security Act. However, the SSA explicitly held the view that resident physicians do not qualify as students.

In 1998, the Eighth Circuit Court of Appeals held that the SSA’s categorical exclusion of medical residents from the definition of student was unsustainable, given that its regulations provided for a case-by-case approach. Following the Eighth Circuit Court of Appeal’s guidance, more than 7,000 claims were filed with the IRS, seeking FICA tax refunds on the grounds that medical residents qualified as students under the essentially identical § 3121(b)(10) of the I.R.C.

Prompted by this immense number of claims, the Treasury determined that it would be necessary to issue regulations “clarifying” the meaning of the term student as used in § 3121(b)(10). The Treasury submitted an amended rule for comment and held a public hearing on the proposed rule. After the notice-and-comment period, the Treasury Department adopted an amended rule effectively excluding medical residents from the definition of “student” under FICA. Subsequent to the promulgation of this

192. Id. at 709 (quoting Bureau of Internal Revenue, Department of the Treasury, 16 Fed. Reg. 12,474 (Dec. 12, 1951)); see Treas. Reg. § 31.3121(b)(10)-2(d) (2011).
193. Mayo, 131 S. Ct. at 709. The primary considerations in the factual analysis were the number of hours worked and the course load taken. Id. (citing Rev. Rul. 78-17, 1978-1 C.B. 306).
197. Mayo, 131 S. Ct. at 709.
199. Student FICA Exception, 69 Fed. Reg. 76404-01, 76,405 (Dec. 21, 2004). In other words, the Treasury abided by the terms of the APA. Id.
200. The amended regulation provides that an employee’s service is “incident” to his studies only when “[t]he educational aspect of the relationship between the employer and the employee, as compared to the service aspect of the relationship, is predominant.” Treas. Reg. § 31.3121(b)(10)-2(d)(3)(i) (2005). The rule also provides that “[t]he services of a full-time employee”—as defined by the employer’s policies, but in any event including any employee normally scheduled to work forty or more hours per week—“are not incident to and for the purpose of pursuing a course of study.” Treas. Reg. § 31.3121(b)(10)-2(d)(3)(iii). As an example, the regulation includes the case of “Employee E,” who is employed by “Uni-
rule, Mayo Foundation filed suit seeking a refund of the money it had withheld and paid on its residents’ stipends during the second quarter of 2005, asserting that its residents were exempt as students and that the new Treasury regulation was invalid.\(^\text{201}\)

The District Court of Minnesota granted summary judgment in Mayo Foundation’s favor, finding that the regulation was inconsistent with the unambiguous text of § 3121, which the court interpreted as dictating that “an employee is a ‘student’ so long as the educational aspect of his service predominates over the service aspect of the relationship with his employer.”\(^\text{202}\) The district court then applied the National Muffler factors to invalidate the regulation.\(^\text{203}\) The Eighth Circuit Court of Appeals reversed, determining that Chevron, not National Muffler, should guide the analysis.\(^\text{204}\) Because I.R.C. § 3121(b)(10) is silent or ambiguous on the issue of whether a medical resident working full-time qualifies as a student and the amended Treasury regulation constituted a permissible interpretation of the Code provision, the Eighth Circuit Court of Appeals held that both steps of Chevron were met and the regulation was enforced.\(^\text{205}\)

The Supreme Court began its analysis in Mayo by announcing the two-step framework of Chevron and asked whether Congress directly addressed the precise question at issue—i.e., whether medical residents are subject to FICA taxes.\(^\text{206}\) The Court found that Congress had not done so.\(^\text{207}\) In the Court’s view, the statutory text did not speak with the precision necessary to state definitively whether the exemption applies to medical residents.\(^\text{208}\)


\(^{202}\) Mayo, 568 F.3d at 1175.

\(^{203}\) Mayo, 568 F.3d at 1176 (citing Nat’l Muffler Dealers Ass’n, Inc. v. United States, 440 U.S. 472 (1979)).

\(^{204}\) Mayo, 568 F.3d at 679-84.

\(^{205}\) Mayo, 568 F.3d at 679-84.


\(^{207}\) Mayo, 131 S. Ct. at 711 (quoting OXFORD UNIVERSAL DICTIONARY 2049-50 (3d ed. 1955)). The Court rejected the taxpayer’s assertion that the dictionary definition of student—one “who engages in study by applying the mind to the acquisition of learning”—necessarily encompasses residents. Id.

\(^{208}\) Id. Thus, the Court rejected the taxpayer’s argument that the case should be resolved at Chevron step one for lack of statutory ambiguity. Id.
The Court then declared its intention to turn to *Chevron* step two.\footnote{Id. at 711.} Before doing so, however, the Court addressed the taxpayer’s argument that *National Muffler*, rather than *Chevron*, should govern the Court’s standard of review, since the ambiguous statute at issue was contained within the I.R.C.\footnote{Id. at 712.} The Court acknowledged that, since deciding *Chevron*, it had cited both *Chevron* and *National Muffler* when reviewing Treasury regulations.\footnote{Id. at 712.} However, aside from past citations to *National Muffler*, the Court found that the taxpayer had advanced no “justification for applying a less deferential standard of review to Treasury Department regulations than . . . to the rules of any other agency.”\footnote{Id. at 712.} Thus, the Court refused to “carve out an approach of administrative review good for tax law only.”\footnote{Id. at 712.}

Instead, the Court explicitly held that the principles of *Chevron* applied with full force in the tax context.\footnote{Id. at 713.} This holds true even for Treasury regulations (such as the FICA regulations at issue) that are promulgated under the general authority contained in I.R.C. § 7805(a).\footnote{Id. at 713.} The *Mead* inquiry, i.e., whether a regulation was promulgated in the exercise of authority and carries the force of law, does not turn on whether Congress’s delegation of authority was general or specific.\footnote{Id. at 713-14.} The authority to “prescribe all needful rules and regulations for the enforcement” of the I.R.C.\footnote{Mayo, 131 S. Ct. at 713.} is the type of explicit Congressional delegation of authority that is required by *Mead*.\footnote{Id. at 713.} Thus, regulations issued pursuant to this delegation of authority merit *Chevron* deference.\footnote{Id.}

Critically, the Court then addressed the procedures utilized by the Treasury when it issued Treasury Regulation § 31.3121(b)(10)-2(e), as follows:

---

209. *Id.* at 711.
210. *Id.* at 712. That is, the Court answered the question posed by tax exceptionalists—whether Treasury regulations are inherently distinct from other bodies of administrative law, such that an entirely different standard of review should be applied. *Id.*
211. *Id.* at 712.
212. *Mayo*, 131 S. Ct. at 713.
213. *Id.* The Court stated that filling gaps in the I.R.C. required the Treasury to make complex interpretive choices, and *Chevron* stood for the proposition that agencies are better equipped than courts to make these types of judgments. *Id.*
214. *Id.* at 713.
215. *Id.*
216. *Id.* at 713-14.
217. *Mayo*, 131 S. Ct. at 713 (quoting I.R.C. § 7805(a) (2012)).
218. *Id.* at 714.
219. *Id.*
The Department issued the full-time employee rule only after notice and comment procedures, 69 Fed. Reg. 76405, again a consideration identified in our precedents as a "significant" sign that a rule merits *Chevron* deference. We have explained that "the ultimate question is whether Congress would have intended, and expected, courts to treat [the regulation] as within, or outside, its delegation to the agency of 'gap-filling' authority."... *Chevron* provide[s] the appropriate standard of review "[w]here an agency rule sets forth important individual rights and duties, where the agency focuses fully and directly upon the issue, where the agency uses full notice-and-comment procedures to promulgate a rule, [and] where the resulting rule falls within the statutory grant of authority."220

The method of promulgation thus played an important role in the Court's consideration of the regulation's validity. Based on these considerations, the Court found that the regulation "easily" satisfied step two of *Chevron*.221 The Treasury reasonably sought a way to define students under FICA, and this reasonable construction is entitled to deference under *Chevron* and *Mead*.222 The Court's decision did not state any view on whether a regulation which had not been promulgated in an appropriate manner would be entitled to the same level of deference. However, the Court's statements regarding the significance of the notice-and-comment process certainly leaves room for argument that an APA-violative regulation would not be afforded the same treatment as one that was enacted in accordance with the APA.

C. The Current Question: What's an Omission, Anyway?

The question posed is likely purely academic, and the answer is one that doesn't make much of a difference.223 However, when ask-
ing the question, "does an overstated basis result in an omission from gross income," please keep in mind the age-old maxim that what matters is not the destination; it is the journey.224

The journey that led from a taxpayer audit to a Supreme Court showdown which has the tax world on the edge of its seat is the focus of the remainder of this article. The current jurisprudential saga began when the IRS and taxpayers disagreed over the meaning of "omits from gross income" contained in I.R.C. § 6501(e).225 The impetus for this disagreement stems from the fact that when a taxpayer omits a significant item of gross income in his return, the IRS has a six year window in which to bring a deficiency action against that taxpayer.226 Otherwise, the IRS is subject to a three year statute of limitations on any deficiency action.227

When a taxpayer overstates his basis in an item of property, the tax liability upon the subsequent sale or exchange of that item will be understated.228 If the IRS catches this understatement on audit, the government can bring a deficiency action against the taxpayer.229 As happened in Home Concrete and the related cases, the IRS caught this understatement sometime between three and six years after the taxpayers submitted their returns.230 Thus, it was critical for the government to convince the courts that the six year statute of limitations should apply. And although the end result is no longer critical, the manner in which the government went about its mission implicates Chevron, the APA, fundamental notions of judicial fairness, and the constitutional balance of governmental powers.231 And who said tax law wasn't exciting?

6501(c)(10) has been effective since 2004; thus, while it cannot be applied to the transactions depicted in this Article, it certainly applies henceforth to all similar transactions.


225. See infra text accompanying notes 248-51.


227. Id. § 6501(a).

228. See supra note 23.

229. I.R.C. § 6212(a).

230. See infra note 239.

231. As Professor Hickman describes it in her Amicus Brief to the Supreme Court, "this is a case about the power of the federal government agencies to define the parameters of the laws that they administer, the limitations that Congress has imposed on agencies as they exercise that power, and the role of the courts in policing agency action." Brief of Amicus Curiae Professor Kristin E. Hickman in Support of Respondents at 3, United States v. Home Concrete & Supply, LLC, 132 S. Ct. 1836 (2012) (No. 11-139), 2011 WL 6813230 at *3.
1. Home Concrete—The One to Reach the Big Stage

In 2012, the Supreme Court decided *United States v. Home Concrete & Supply, LLC.* The *Home Concrete* case is representative of a line of cases that first appeared in front of the Tax Court in 2007. A quick summary of the facts of *Home Concrete* is representative of the entire line of cases and will suffice to provide context for the pertinent judicial deference issues.

The taxpayer-plaintiffs in *Home Concrete* engaged in a classic son-of-BOSS tax shelter plan. An overview of the taxpayers’ business dealings will provide more clarity to the issues at stake than would a full reiteration of the details of their transactions. The plan began when one of the owners of a business, Home Oil & Company, wanted to sell his share of the company while minimizing his tax liability. In order to accomplish this, the owner transferred his business assets from the corporation to a newly-formed partnership, inflated his basis in the partnership by short-selling Treasury bonds, then sold his interest in the partnership at a much lower gain than he would have, had he simply sold his original interest in the corporation. Of course, reporting

---

232. 132 S. Ct. 1836.
234. These tax shelters have now been expressly forbidden by the IRS and any users or promoters of such transactions are subject to various penalties. I.R.S. Notice 2000-44, 2000-2 C.B. 255.
236. *Home Concrete*, 634 F.3d at 251 & n.2. A partner's basis in his partnership interest is referred to as "outside basis," whereas a partnership's basis in its assets is known as "inside basis." *See* I.R.C. §§ 722-23 (2011).
237. A short sale is a "sale of a security that the seller does not own or has not contracted for at the time of sale, and that the seller must borrow to make delivery." *Black's Law Dictionary* 1456 (9th ed. 2009). To close the short sale, "[t]he short seller is obligated . . . to buy an equivalent number of shares [or substantially identical security] in order to return the borrowed [property]." *Kornman & Assocs., Inc. v. United States*, 527 F.3d 443, 450 (5th Cir. 2008). After utilizing these short sales, the partner was able to artificially increase his basis in the partnership by "stepping up" his basis under I.R.C. § 743(b)(1), which reads:

In the case of a transfer of an interest in a partnership by sale or exchange or upon the death of a partner, a partnership with respect to which the election provided in section 754 is in effect or which has a substantial built-in loss immediately after such transfer shall

1. increase the adjusted basis of the partnership property by the excess of the basis to the transferee partner of his interest in the partnership over his proportionate share of the adjusted basis of the partnership property.

I.R.C. § 743(b)(1), quoted in *Home Concrete*, 634 F.3d at 252.
a lower gain meant paying less tax on that gain. The only problem, in the government's eyes, was that none of the transactions undertaken by the taxpayer had any real economic substance.

The tax return reported the basic components of the transaction, and the IRS did not investigate until June of 2003. On September 7, 2006, the IRS issued a Final Partnership Administrative Adjustment ("FPAA") to Home Concrete. The FPAA decreased the taxpayers' reported outside bases in Home Concrete to zero, finding that the short sale and subsequent sales lacked economic substance and were sham transactions. This substantially increased the taxpayers' respective taxable income for 1999. Home Concrete deposited over $1 million with the IRS and sued in the Federal District Court for the Eastern District of North Carolina to recover the deposit. The basis of Home Concrete's refund action was that the FPAA was barred by the three year statute of limitations contained in I.R.C. § 6501(a). The IRS countered by arguing that the six year statute of limitations in I.R.C. § 6501(e)(1)(a), not the three year default limitations statute, should apply under this set of facts.

---

236. The taxpayer-plaintiffs were able to sell a $10 million company and report less than $100,000 in gain, by utilizing the short sales of Treasury bonds to increase their basis in the property. Home Concrete, 634 F.3d at 252; see also I.R.S. Notice 2000-44, supra note 234.
239. See I.R.C. § 1001(a).
240. Home Concrete, 634 F.3d at 252.
241. Id.
242. Id.; see also I.R.C. § 6223 (defining and explaining the procedure for issuing an FPAA).
243. Home Concrete, 634 F.3d at 252. The FPAA detailed that:

[The purported partnership was formed and availed of solely for purposes of tax avoidance by artificially overstating basis in the partnership interests of its purported partners. . . . [T]he acquisition of any interest in the purported partnership by the purported partner, short sales of Treasury Notes, the transfer of proceeds from short sales of Treasury Notes or other assets to a partnership in return for a partnership interest, the purchase or disposition of assets by the partnership, and the distribution of those assets or proceeds from the disposition of those assets to the purported partners, and the subsequent sale of those assets to generate a loss, all within a period of 8 months, had no business purpose other than tax avoidance, lacked economic substance, and, in fact and substance, constitutes an economic sham for federal income tax purposes. Accordingly, the partnership and the transactions described above shall be disregarded in full and (1) any purported losses resulting from these transactions are not allowable as deductions; and (2) increases in basis of assets are not allowed to eliminate gain for federal income tax purposes.

Id.
244. Id. The total taxable income increase was $1,392,118. Id.
245. Id. at 252-53.
246. Id. at 253.
247. Id.
Thus, the legal crux of *Home Concrete* centered on which limitations period should apply; the longer limitations period applies when a taxpayer "omits from gross income an amount properly includable" and the omitted item exceeds 25 percent of the amount of gross income stated in that taxpayer's return.\(^\text{248}\) The ultimate decision in *Home Concrete*, therefore, turned on whether an overstated basis constitutes an omission from gross income.\(^\text{249}\) After the district court granted partial summary judgment in favor of the IRS,\(^\text{250}\) the taxpayer appealed to the Court of Appeals for the Fourth Circuit, arguing that a prior Supreme Court decision foreclosed the lower court's interpretation of "omission from gross income."\(^\text{251}\)

In their argument to the circuit court, the taxpayers argued that the Supreme Court's decision in *Colony Inc. v. Commissioner* should control the outcome of the litigation,\(^\text{252}\) a case in which the Court addressed whether an overstated basis should constitute an omission from gross income.\(^\text{253}\) The 1939 version of the I.R.C. was in effect at the time of *Colony*, and the extended statute of limitations provision was contained in I.R.C.§ 275(c).\(^\text{254}\) After examining the language of § 275(c), the Court found this provision to be ambiguous, and as such, the text did not clearly answer whether Congress intended an overstated basis to constitute an omission from gross income.

Turning then to the legislative history of § 275(c), the Court found that the purpose of the extended statute of limitations was to assist the Commissioner of Internal Revenue, who would be at a disadvantage when an item had actually been omitted from a taxpayer's return.\(^\text{255}\) An overstatement of basis, on the other hand,

---


\(^{249}\) *Home Concrete*, 634 F.3d at 253. There is no dispute that, if the overstated basis constitutes an omission from gross income, such omission would exceed 25 percent of the taxpayers' stated gross income for 1999. *Id.*


\(^{251}\) *Home Concrete*, 634 F.3d at 253.

\(^{252}\) *Id.*

\(^{253}\) *Colony, Inc. v. Comm'r*, 357 U.S. 28 (1958)).

\(^{254}\) *Colony*, 357 U.S. at 29 n.1 (citing I.R.C. § 275(c) (1939)). This provision called for a five year statute of limitations for the IRS to bring a deficiency action when a taxpayer omits an item from gross income. *Id.*

\(^{255}\) *Id.* at 33.

\(^{256}\) *Id.* at 36.
does not pose this same problem. Therefore, the Court refused to interpret "omit" broadly.

Critical to the taxpayers' argument in *Home Concrete*, the *Colony* Court stated in dicta that its holding was in harmony with the unambiguous language of I.R.C. § 6501(e)(1)(A). Citing this dicta, the circuit court in *Home Concrete* agreed that the current I.R.C. limitations provision is unambiguous, and therefore, an overstated basis is no more an omission from gross income in today's tax landscape than it was at the time of *Colony*.

And this is where the IRS decided to press a new path—a path which leads directly to the question of *Chevron* deference. On September 28, 2009, the Treasury had promulgated a temporary regulation, which became final during the pendency of the *Home Concrete* appeal. This regulation, directly aimed at influencing the outcome of the *Home Concrete* line of cases, provides:

(a) Income taxes --(1) General rule. (i) If a taxpayer omits from the gross income stated in the return of a tax imposed by subtitle A of the Internal Revenue Code an amount properly includible therein that is in excess of 25 percent of the gross income so stated, the tax may be assessed, or a proceeding in court for the collection of that tax may be begun without assessment, at any time within 6 years after the return was filed.

(iii) For purposes of paragraph (a)(1)(i) of this section, the term gross income, as it relates to any income other than from the sale of goods or services in a trade or business, has the

---

257. *Id.* From a common sense perspective, when a taxpayer has included an item of gain within his return, even where the gain is understated, it is possible for an examiner to investigate the propriety of the reported gain on audit with the information that has been provided. This is, of course, distinct from a situation where nothing has been reported, and the examiner, therefore, would not be alerted as to the need for further investigation.

258. *Id.* at 36-37.


260. *Home Concrete*, 634 F.3d at 255 ("[W]e hold that the Supreme Court in *Colony* straightforwardly construed the phrase 'omits from gross income,' unhinged from any dependency on the taxpayer's identity as a trade or business selling goods or services. . . . *Colony* forecloses the argument that *Home Concrete*'s overstated basis in its reporting of the short sale proceeds resulted in an omission from its reported gross income.").

261. *Id.*

262. *Id.* (citing Treas. Reg. § 301.6501(e)-1 (2010)).
same meaning as provided under section 61(a) [26 USCS § 61(a)], and includes the total of the amounts received or accrued, to the extent required to be shown on the return. In the case of amounts received or accrued that relate to the disposition of property, and except as provided in paragraph (a)(1)(ii) of this section, gross income means the excess of the amount realized from the disposition of the property over the unrecovered cost or other basis of the property. Consequently, except as provided in paragraph (a)(1)(ii) of this section, an understated amount of gross income resulting from an overstatement of unrecovered cost or other basis constitutes an omission from gross income for purposes of [I.R.C.] section 6501(e)(1)(A)(i). 263

Quite simply, this new regulation overturned the Colony rule and explicitly included an overstatement of basis within the definition of an omission from gross income. 264 Although Brand X makes clear that an agency may overturn prior judicial interpretations of ambiguous statutes through the issuance of contrary regulations, the Treasury did not follow proper procedure when it promulgated Treasury Regulation § 301.6501(e)-1. 265

Predictably, the taxpayers mounted numerous challenges to the application of this new regulation. As a preliminary matter, the taxpayers debated whether the regulation could be applied to their case at all, considering that the regulation was not in effect when

263. Treas. Reg. § 301.6501(e)-1 (emphasis added).
264. Home Concrete, 634 F.3d at 255-56.
265. See supra text accompanying note 168. In September 2009, the Treasury issued and published in the Federal Register and Internal Revenue Bulletin a temporary but legally binding regulation, Temp. Treas. Reg. § 301.6501(e)-1T (2009). See T.D. 9466, 2009-43 I.R.B. 551. Simultaneously, the Treasury issued and published a notice of proposed rulemaking containing nearly identical regulatory language as the temporary regulation and then entertained public comment. See Definition of Omission from Gross Income, 74 Fed. Reg. 49,354 (Sept. 28, 2009). In December 2010, the Treasury withdrew the temporary regulation and published the virtually identical final regulation. See Definition of Omission from Gross Income, 75 Fed. Reg. 78,897 (Dec. 17, 2010). As explained in notes 107 through 110, supra, and accompanying text, the promulgation of temporary regulations concurrent with notices of proposed rulemaking violates the APA, because post-promulgation notice-and-comment is not a valid substitute for statutorily required pre-promulgation notice-and-comment. The Treasury did not provide any justification for its failure to abide by the APA sufficient to meet one of the exceptions to APA § 553, merely stating that APA § 553(b) "does not apply to these regulations." Id. at 78898; T.D. 9466, 2009-43 I.R.B. 551. Thus, the procedures employed by the Treasury in promulgating Treas. Reg. § 301.6501(e)-1 indisputably violated the Administrative Procedure Act.
the transactions at issue occurred. The regulation was promulgated after the transaction in *Home Concrete* took place, the IRS argued that it should still be applied to the *Home Concrete* case, because the IRS issued its FPAA within six years of the transaction. Whether application of this regulation would involve an impermissible retroactive reach was considered in *Home Concrete*, but a thorough analysis of this issue is beyond the scope of this Article.

Assuming that the regulation can properly be applied to the transaction at issue, the question remains open as to whether the regulation should be afforded *Chevron* deference. The Court of Appeals for the Fourth Circuit ruled that it should not, because I.R.C. § 6501(e)(1)(A)—the statute which the regulation purports to interpret—is unambiguous. Thus, *Chevron* step one is not satisfied. The court was unimpressed by the IRS's argument that *Brand X* controls the inquiry. The Fourth Circuit Court of Appeals did not base its holding on stare decisis faithfulness to the Supreme Court's prior interpretation in *Colony*. In fact, the *Home Concrete* court acknowledged that subsequent agency interpretation (here, Treasury Regulation § 301.6501(e)-i) could displace an earlier judicial construction of the same statute (here, *Home Concrete*, 634 F.3d at 256. The express applicability date of the regulation was “taxable years with respect to which the period for assessing tax was open on or before September 24, 2009.” Treas. Reg. § 301.6501(e)-1(e). The tax year at issue in *Home Concrete* was 1999. *Home Concrete*, 634 F.3d at 256.

266. *Home Concrete*, 634 F.3d at 256. The express applicability date of the regulation was “taxable years with respect to which the period for assessing tax was open on or before September 24, 2009.” Treas. Reg. § 301.6501(e)-1(e). The tax year at issue in *Home Concrete* was 1999. *Home Concrete*, 634 F.3d at 256.

267. *Home Concrete*, 634 F.3d at 256 The IRS urged a different interpretation of the regulation's applicability clause than the straightforward interpretation which would result in a clear finding that the regulation did not apply to the tax year 1999. *Id.*. The IRS's interpretation can be found in the preamble to Treasury Decision 9511, which promulgated the regulation. *Id.* (citing T.D. 9511, 2011-6 I.R.B. 455). In this preamble, the Treasury suggests that “the six-year period for assessing tax” in § 6501(e)(1) remains open for “all taxable years . . . that are the subject of any case pending before any court of competent jurisdiction . . . in which a decision had not yet become final . . . .” *Id.* (quoting T.D. 9511, 2011-6 I.R.B. 455). Because the *Home Concrete* case was not finally resolved as of September 24, 2009, according to the logic of the preamble, the period for assessing tax remained open and Treas. Reg. § 301.6501(e)-1 would apply. *Id.* at 256. The Court of Appeals for the Fourth Circuit found that this was an impermissible attempt to redraft the limitations statute of § 6501. *Home Concrete & Supply, LLC v. United States*, 634 F.3d 249, 256-57 (4th Cir. 2011) (“[T]he IRS's argument that the period for assessing tax is open—or indeed may be re-opened, as would be the case here—so long as litigation is pending is contrary to the clearly and unambiguously expressed intent of Congress and must fail.”), aff'd, 132 S. Ct. 1836 (2012).

268. *Id.* at 256-57.

269. *Id.* at 257.

270. *Id.* (“*Chevron* deference is warranted only when a treasury regulation interprets an ambiguous statute.”).

271. *Id.*
Duquesne Law Review

Colony), assuming that the statute was ambiguous. However, the court stated that the regulation was not interpreting an ambiguous statute, but rather was attempting to change the governing statutory law by impermissibly altering Congress's express intent.

In a concurring opinion, Judge Wilkinson explained the policy rationale behind the court's decision. Judge Wilkinson recognized that Chevron and Brand X afford agencies "considerable discretion in their areas of expertise." However, Judge Wilkerson continued:

Yet it remains the case that agencies are not a law unto themselves. No less than any other organ of government, they operate in a system in which the law words in law belong to Congress and the Supreme Court. What the IRS seeks to do in extending the statutory limitations period goes against what I believe are the plain instructions of Congress, which have not been changed, and the plain words of the Court, which have not been retracted.

Judge Wilkerson concluded that the agency had exceeded the point of expert, beneficial agency guidance and crossed the line into arbitrariness when it issued Treasury Regulation § 301.6501(e)-1.

Not to be so easily deterred, the government filed its petition for certiorari to the Supreme Court on August 3, 2011, which was subsequently granted. The government posed two questions for the Court's review: first, whether an understatement of gross income attributable to an overstatement of basis in sold property is an omission from gross income that can trigger the extended six year statute of limitations; and second, whether the final regulation promulgated by the Treasury is entitled to judicial deference.

273. Home Concrete, 634 F.3d at 257-58.
274. Id. at 258-60 (Wilkerson, J., concurring).
275. Id. at 259.
276. Id.
277. Id.
280. Petition for a Writ of Certiorari, supra note 278, at *1.
The taxpayers responded and requested that the Court deny certiorari.281 The taxpayers’ opening brief argued that the Colony decision is controlling per absence of statutory ambiguity.282 Beyond the mechanical application of Chevron step one, however, the taxpayers argued that deference should not be granted for policy reasons.283 First, the regulation at issue was used in an attempt to “guarantee a win” for the IRS, rather than to truly issue interpretive guidance for taxpayers.284 Moreover, the taxpayers argued that the regulation is not entitled to Chevron deference, because unlike the judicial construction of the statute at play in Brand X, the Supreme Court’s interpretation in Colony was the only permissible reading of the statute, rather than just the “best” reading.285 Finally, the taxpayers argue in their merit brief that the regulation is procedurally defective and that it also fails Chevron step two.286

2. The Rest of the Overstated Bases Cases—Inconsistency Reigns Supreme

The Fourth Circuit was not the only appellate court to address the meaning of “omits from gross income” or to apply the Chevron doctrine to Treasury Regulation 301.6501(e)-1. In fact, these precise issues have been decided by the District of Columbia,287 Federal,288 Fifth,289 Seventh,290 and Ninth291 Circuit Courts of Appeal.

282. Id. at 8-33. Under Chevron step one, the taxpayers argued, the statute at issue relative to an omission from gross income is unambiguous and leaves no room for agency interpretation. Id. at 30.
283. Id. at 26-29.
284. Id. at 27. On a related note, the regulation changes the law that was settled by the Supreme Court in Colony more than fifty years prior to the regulation’s promulgation—thereby belying the government’s claim that its regulation was a mere “clarification” of statutory intent. See id.
285. Id. at 30-32.
286. See Brief of Respondents at 49-50, United States v. Home Concrete & Supply, LLC, 132 S. Ct. 1836 (2012) (No. 11-139). This issue is more fully developed in an Amicus Curiae brief filed by Professor Hickman on behalf of the taxpayers-respondents. See infra note 329.
289. Burks v. United States, 633 F.3d 347 (5th Cir. 2011).
The results reached by the circuits have been anything but consistent.

The District of Columbia Circuit (“D.C. Circuit”) decided Intermountain Insurance Service of Vail, L.L.C. v. Commissioner in June of 2011. Like Home Concrete, this was another inflated basis case with an FPAA that would be considered timely under a six year statute of limitations, but untimely under a three year limitations period. After the Tax Court granted summary judgment in favor of the taxpayers, the Treasury promulgated the temporary regulation. The IRS moved for reconsideration in the Tax Court. The Tax Court denied reconsideration, finding that the statute of limitations had expired before the regulation’s effective date, and that, even if the time period had not expired, Colony unambiguously foreclosed the Treasury’s interpretation of “omits from gross income.”

On appeal, the D.C. Circuit explored in detail the background of Colony and the legislative history of the 1954 Code in order to justify its conclusion that I.R.C. § 6501 does not unambiguously provide that overstatements of basis do not trigger the six year statute—even though the same statutory term “omission from gross income” in the 1939 Code was construed in Colony not to include such overstatements. Rather, the D.C. Circuit explained that Colony did not stand for the proposition that § 6501(e)(1)(A) was unambiguous in its entirety, as this would contradict its earlier statement that the similarly-worded § 275(c) was ambiguous. A more logical reading of Colony, according to the D.C. Circuit, is that the Court found only subsection (i) of § 6501(e)(1)(A), and not the entire section, to be unambiguous.

292. Intermountain, 650 F.3d 691.
293. Id. at 695.
294. Id. at 696.
295. Id.
296. Id.
297. Intermountain, 650 F.3d at 696-700.
298. Id. at 702-03.
299. Id. at 703. The Intermountain taxpayer urged the court that the statement made by the Colony Court—“the conclusion we reach [about the meaning of section 275(c)] is in harmony with the unambiguous language of [section] 6501(e)(1)(A)”—referred to the principal paragraph of § 6501(e)(1)(A), i.e., the section referring to omission from gross income. Id. at 702-703 (quoting Colony, Inc. v. Comm’r, 357 U.S. 28, 37 (1958)). However, the D.C. Circuit noted that subsection (i) of § 6501(e)(1)(A) (redefining gross income to mean gross receipts) is “certainly unambiguous,” and therefore, a more sensible reading of the Colony opinion is that the Court was referring only to that subsection, and not the entire section.
Continuing with *Chevron* step one, the D.C. Circuit found that the phrase “omits from gross income” is at least ambiguous, if not best read to include basis overstatements. Finding that *Chevron* step one was satisfied, the court then stated that the *Chevron* step two analysis is “easy,” because the only argument against reasonableness is that the Treasury’s new interpretation conflicts with *Colony*, which the court already found not to be controlling. In passing, the D.C. Circuit addressed the APA. However, the court did not searchingly examine the Treasury’s violation of APA mandates—rather, the court expressed the opinion that the Commissioner underwent “searching consideration” of the comment that was presented after the temporary regulation was promulgated. This, the court found, was enough to warrant judicial deference.

The Federal Circuit’s decision in *Grapevine Imports, Ltd. v. United States* was the first case to squarely address the deference question as applied to Treasury Regulation § 301.6501(e)-1. At the trial level, the Court of Federal Claims had relied on *Colony* and found that it controlled, thereby denying the government’s claim. The timing of *Grapevine*, however, put the judicial deference question front and center, as oral arguments in *Grapevine*, Ltd. v. United States, 636 F.3d 1368 (Fed. Cir. 2011), vacated, 132 S. Ct. 2099 (2012) (mem.).

---

300. *Id.* at 703-705.

301. *Id.* at 707.

302. *Intermountain*, 650 F.3d at 709 (“Here, the Commissioner simultaneously issued immediately effective temporary regulations and a notice of proposed rulemaking for identical final regulations and then held a 90-day comment period before finalizing the regulations. According to [taxpayers], that procedure, although typical of the Commissioner’s practice, violates the Administrative Procedure Act, thus requiring an open-mindedness inquiry.”).

303. *Id.* at 709-10. The court found that because the Commissioner only received one comment upon publication of the temporary regulations and did respond to such comment (albeit by expressing disagreement with the comment and changing nothing in the regulations), the final regulations were validly promulgated. *Id.* at 710.

304. *Id.* at 710.


306. *Grapevine Imps., Ltd. v. United States*, 77 Fed. Cl. 505, 511-12 (2007), rev’d, 636 F.3d 1368 (Fed. Cir. 2011), vacated, 132 S. Ct. 2099 (2012) (mem.). Before appellate briefing began in *Grapevine*, Grapevine moved to have the appeal consolidated with another Son of BOSS case, *Salman Ranch, Ltd. v. United States*, 573 F.3d 1362 (Fed. Cir. 2009), which was then pending before another Federal Circuit panel. *Grapevine*, 636 F.3d at 1374. The *Grapevine* panel denied consolidation, but agreed to stay the proceedings until *Salman Ranch* was decided. *Id.* In *Salman Ranch*, the Federal Circuit Panel ruled that the government’s case was time-barred. *Id.* Shortly after *Salman Ranch* was decided, the Treasury issued the temporary regulation, implementing the Department’s interpretation of the statute of limitations and the statute’s interaction with *Colony*. *Id.* at 1374-75.
vine were held one day after the Supreme Court decided Mayo.\textsuperscript{307} The government quickly embraced Mayo's affirmation of the legal weight afforded to Treasury regulations, arguing that it compelled judicial deference to the new regulation.\textsuperscript{308} The Federal Circuit agreed, finding that "the new Treasury regulations are entitled to deference in interpreting the statutory language, and . . . under the regulations' interpretation, the government's case is not time-barred."\textsuperscript{309}

In \textit{Chevron} step one, the Federal Circuit found that Congress's intent when enacting § 6501(e)(1)(A) was not so clear as to foreclose reinterpretation.\textsuperscript{310} If more than one reasonable interpretation of Congress's intent can be made, then the agency, not the judiciary, has the interpretive mandate.\textsuperscript{311} Furthermore, the fact that prior courts reasonably interpreted the statute did not mean that the inherent ambiguity of § 6501(e)(1)(A) had been wiped away; therefore, the court found that it must defer to the Treasury's interpretation.\textsuperscript{312}

The Federal Circuit's analysis of \textit{Chevron} step two is critical. The taxpayer in \textit{Grapevine} had argued that the temporary Treasury regulation should not receive \textit{Chevron} deference because of "procedural shortcomings" in the regulation's issuance.\textsuperscript{313} The court did not discuss the merits of this claim. Rather, the court declared that because the regulations had been issued in their final form prior to judicial review, arguments regarding procedural violations have become moot.\textsuperscript{314} The court then found that there was "little doubt" that final Treasury regulations are entitled to \textit{Chevron} deference.\textsuperscript{315}

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{308} See \textit{Grapevine}, 636 F.3d at 1377.
\item \textsuperscript{309} \textit{Id.} at 1371.
\item \textsuperscript{310} \textit{Id.} at 1376.
\item \textsuperscript{311} \textit{Id.} at 1378.
\item \textsuperscript{312} \textit{Id.} at 1379.
\item \textsuperscript{313} \textit{Grapevine}, 636 F.3d at 1380.
\item \textsuperscript{314} \textit{Id.} at 1380. In other words, because the Treasury did accept public comment before issuing the final regulations (i.e., engage in classic interim-final rulemaking), the fact that it chose not to do so prior to issuing the binding, temporary regulations was of no concern to the court.
\item \textsuperscript{315} \textit{Id.} (citing Mayo Found. for Med. Educ. & Research v. United States, 131 S. Ct. 704, 714 (2011)).
\end{itemize}
\end{footnotesize}
The Fifth Circuit took precisely the opposite tack to the regulations when it rendered its decision on the overstated basis issue.\(^{316}\) In *Burks v. United States*, the Fifth Circuit found *Colony* to be controlling with respect to the phrase "omits from gross income."\(^{317}\) Because the court decided that the statute was unambiguous, the deference analysis failed at *Chevron* step one, and there was no need to give further consideration to the regulation.\(^{318}\) Yet, the Court of Appeals for the Fifth Circuit did not stop its opinion at that point, but issued a provocative statement of dicta regarding the government's argument for *Chevron* deference.\(^{319}\)

The court considered how the recent *Mayo* decision should impact the judicial deference question relative to regulations like the one at issue.\(^{320}\) The court explicitly declared that it would not have deferred to the regulation under *Chevron*, even if the statute were ambiguous.\(^{321}\) On this point, the court emphasized an important difference between *Mayo* and the overstated basis cases—namely, the litigation-aimed nature of the regulations that were promulgated absent notice-and-comment.\(^{322}\) Noting that the Supreme Court has said that it is inappropriate to defer "to what appears to be nothing more than the agency's convenient litigating position,"\(^{323}\) the Fifth Circuit stated that the "Commissioner 'may not take advantage of his power to promulgate regulations during the course of a litigation for the purpose of providing himself with a defense based on the presumption of validity accorded to such regulations.'"\(^{324}\)

In addition, the court questioned the propriety of the government's request for deference to final regulations that were largely

\(^{316}\) *Burks v. United States*, 633 F.3d 347 (5th Cir. 2011).

\(^{317}\) *Burks*, 633 F.3d at 351, 353.

\(^{318}\) *Id.* at 360.

\(^{319}\) *Id.* at 360 n.9 (citing *Mayo*, 131 S. Ct. at 711).

\(^{320}\) *Id.*

\(^{321}\) *Id.* at 360 & n.9 (citing *Mayo*, 131 S. Ct. at 711). That is, even if the regulation had passed *Chevron* step one, the Fifth Circuit would have found the regulation deficient at *Chevron* step two.

\(^{322}\) *Burks*, 633 F.3d at 360 n.9 ("Mayo emphasized that the regulations at issue had been promulgated following notice and comment procedures, 'a consideration identified ... as a significant sign that a rule merits *Chevron* deference.' Legislative regulations are generally subject to notice and comment procedure pursuant to the Administrative Procedure Act. Here, the government issued the *Temporary Regulations without subjecting them to notice and comment procedures. This is a practice that the Treasury apparently employs regularly.") (citations omitted)).

\(^{323}\) *Id.* (citing *Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 213 (1988)).

\(^{324}\) *Id.* (quoting *Chock Full O' Nuts Corp. v. United States*, 453 F.2d 300, 303 (2d Cir. 1979)).
indistinguishable from the temporary regulations, admonishing that the fact "[t]hat the government allowed for notice and comment after the final Regulations were enacted is not an acceptable substitute for pre-promulgation notice and comment." With this sentence, the Fifth Circuit became the only circuit amongst the overstated basis courts to explicitly recognize that regulations promulgated without notice-and-comment should not automatically be granted *Chevron* deference.

When the issue was presented to the highest Court, the Justices had the choice of continuing the nearly five-year long journey toward final resolution down one of numerous paths. The Court, in a plurality decision authored by Justice Breyer, ultimately decided in favor of the taxpayer on *Colony* grounds; i.e., that the statute is unambiguous as stated in *Colony*, and thus, no room exists for subsequent agency interpretation and ended its opinion at that point. The dissenting opinion, written by Justice Kennedy and joined by Justices Ginsburg, Sotomayor, and Kagan found the definition of "omits from gross income" to be ambiguous, and nonetheless, swept aside the *APA* violations. Thus, as a whole, the Court's opinion completely avoided laying down a broad-based rule that *APA* violations will affect the judicial deference equation.

---

325. *Id.* (emphasis added) (citing U.S. Steel Corp. v. EPA, 595 F.2d 207, 214-15 (5th Cir. 1979)).

326. Two other circuits, the Seventh and the Ninth, also addressed the overstated-basis-as-omission issue. *See* *Beard* v. Comm'r, 633 F.3d 616 (7th Cir. 2011), *vacated*, 132 S. Ct. 2099 (2012) (mem.); *Bakersfield Energy Partners, LP v. Comm'r*, 568 F.3d 767 (9th Cir. 2009). *Beard* only addressed the application of *Colony* to the facts of the case and did not address the viability or applicability of the regulation. *Beard*, 633 F.3d 616, 619-23. The case out of the Ninth Circuit, *Bakersfield*, was decided before Treas. Reg. § 301.6501(e)-1 (2011) was in place. 568 F.3d 767. The Ninth Circuit followed *Colony* and held in favor of the taxpayer. *Id.*

327. In this case, the Court could refuse to defer to the regulation at *Chevron* step one. Whether the regulation was issued properly and should be given deference, i.e., the step two inquiry, would not be reached, unless in dicta.

328. The dissent fails to even mention the Administrative Procedure Act or the arguments raised by the respondents and amici addressing the regulation's *APA* violations. The dissenting opinion should be troubling to taxpayers and those in favor of enforcing the *APA*. Both the respondents and amici expressly noted the *APA* violations committed by the Treasury and argued that these violations should lead to a conclusion that the regulation fails at *Chevron* step two. *See generally*, Brief of Amicus Curiae Professor Kristin E. Hickman in Support of Respondents, *supra* note 231. However, the dissent would have granted deference to the agency regulation based *purely* on the finding that the interpreted statute was ambiguous. *See Home Concrete*, 132 S. Ct. 1836, 1849-53 (Kennedy, J., dissenting). *Chevron* step two was not even mentioned in passing. The most troubling aspect of the dissent is the fact that Justice Kennedy was joined by three other justices, including relatively new Justices Sotomayor and Kagan. *Id.* at 1849. The potential implications of the dissenting opinion and its wholesale failure to recognize the second step of *Chevron* may form the subject of a future article.
Thus, the Court missed a valuable opportunity to shed clarity on a hazy area of administrative procedure and judicial doctrine. *Home Concrete* provided a fine opportunity for the Court to definitively rule that APA-violative regulations will fail to garner mandatory judicial deference. The Court wholly failed, even in dicta, to do so. Thus, it is likely that this issue will present itself before the Court again, and the importance of notice-and-comment rule-making is anything but a purely academic issue. In order for the Supreme Court to rule on the issue it failed to address in *Home Concrete*, it must find that *Chevron* provides the appropriate standard of review for APA-violative regulations and that these procedurally defective regulations fail at *Chevron* step two.

**IV. AGENCY REGULATIONS THAT VIOLATE THE APA FAIL TO QUALIFY FOR DEFERENCE UNDER STEP TWO OF CHEVRON**

In order to find that APA-violative regulations fail at *Chevron* step two, the Court must first determine that *Chevron* in fact provides the appropriate standard of review. *Chevron* review should be utilized when reviewing *Home Concrete*-esque regulations—i.e., those regulations which violate the APA yet carry legal force—quite simply, because the doctrinal prerequisites of *Chevron* are present even if Treasury has not abided by the APA when promulgating its regulation. The use of *Chevron* deference is required where: (1) an agency has issued a regulation pursuant to Congressional authority, and (2) that regulation carries the force of law. Treasury regulations issued pursuant to I.R.C. § 7805(a)

329. In this vein, Professor Hickman has submitted an amicus curiae brief in support of the taxpayer-respondents, calling the Court's attention to the procedural violations committed by the Treasury and urging the Court to invalidate Treas. Reg. § 301.6501(e)-1 at *Chevron* step two. See Brief of Amicus Curiae Professor Kristin E. Hickman in Support of Respondents, *supra* note 231.

330. See Hickman, *supra* note 66, at 1758. Professor Hickman's empirical analysis of the Treasury regulations found that the Treasury often receives "significant input" from the public when it does submit regulations for comment. *Id.* Out of the 131 projects which had reached a stage at which it was disclosed whether or not the Treasury had received comments, 96 (73.3 percent) generated at least one comment raising concerns or suggesting changes. *Id.* This finding suggests that the majority of the time, regulations that are submitted for notice and comment will actually receive comments. In other words, the notice-and-comment process works. It is not a mere formality designed to suggest public participation; it actually fosters public discourse. This realization makes the lack of notice-and-comment on so many occasions all the more disconcerting.

331. In other words, *Chevron* must be the starting point for the Court's analysis, rather than one of the deference alternatives, e.g., *National Muffler* or *Skidmore*.

invariably meet these requirements.\textsuperscript{333} Neither jurisprudential nor normative support any longer exists for an argument that \textsection{7805(a)} regulations should be analyzed using any other standard of review than \textit{Chevron}.

\textit{Mayo} all but foreclosed the possibility of approaching Treasury regulations from a \textit{National Muffler} standpoint.\textsuperscript{334} Although a multi-factor approach to regulations certainly provides greater flexibility, the United States Supreme Court has made clear that when Congress places the primary authority for interpreting statutes in the hands of an administrative agency, the judiciary should defer to that agency so long as it has acted reasonably. Thus, affording Treasury regulations only \textit{Skidmore} respect from the outset would not honor the precedential mandates of the Court.\textsuperscript{335}

Even when a Treasury regulation has been issued without notice-and-comment, it still carries the force of law.\textsuperscript{336} Procedural defects do not give taxpayers an excuse from complying with tax regulations when they file their returns. If taxpayers fail to comply with a regulation—even a procedurally defective one—they can be subject to penalties and legal sanctions.\textsuperscript{337} Moreover, very few procedurally defective Treasury regulations are challenged and invalidated under the APA.\textsuperscript{338} Thus, the Court is considering a regulation that carries the force of law and must be analyzed under \textit{Chevron}.

On a simplistic level, therefore, the holding of \textit{Mayo} would seem to apply to the Court’s decision in \textit{Home Concrete}. \textit{Mayo} held that Treasury regulations are entitled to no less deference than any other administrative regulations, and whether the regulations were promulgated via \textsection{7805(a)} or otherwise, \textit{Chevron} pro-

\textsuperscript{334} \textit{See Mayo}, 131 S. Ct. at 714. Moreover, the recent \textit{Home Concrete} decision reinforces the utilization of \textit{Chevron} as the starting point for Treasury regulations. The Court proceeded to analyze the \textit{Home Concrete} interpretive issue under \textit{Chevron} even though the case was clearly tax-specific. \textit{See Home Concrete}, 132 S. Ct. at 1843-44.
\textsuperscript{335} \textit{See Mead}, 533 U.S. at 226-27. \textit{Skidmore} respect is only appropriate when reviewing those agency actions that do not carry the force of law. \textit{Id.} For example, in the case of the Treasury/IRS, actions such as issuing Revenue Rulings or Private Letter Rulings would be subject to a \textit{Skidmore} review, because such actions may be persuasive but are not binding.
\textsuperscript{336} Although APA \textsection{706} mandates that courts invalidate procedurally-defective regulations, if no party has challenged the regulation under \textsection{706}, then the regulation stands as agency law. \textit{Administrative Procedure Act}, 5 U.S.C. \textsection{706} (2006).
\textsuperscript{337} \textit{See I.R.C. \textsection{6662} (2006).
\textsuperscript{338} \textit{See infra Part V}. 
provides the appropriate standard of review. Thus, under this chain of logic and precedent, one could argue that Treasury Regulation § 301.6501(e)-1 is entitled to Chevron deference. However, this surface-level analysis misses the link between Chevron review and Chevron deference—merely finding that Chevron is the appropriate standard only means that a regulation is entitled to mandatory deference if it meets the two-part test. This is where the Home Concrete regulation diverges from the Mayo regulation.

From a stare decisis perspective, the regulations considered and afforded deference in Mayo Foundation are fundamentally dissimilar from the regulations at play in Home Concrete; thus, Mayo's pro-deference holding does not constitute binding precedent for the Home Concrete Court. The regulations in Mayo were promulgated in compliance with the APA and were not interim-final rules aimed at influencing pending litigation. The regulations in Home Concrete, of course, are precisely the opposite. Although Mayo unequivocally held that § 7805(a) Treasury regulations are afforded Chevron deference pursuant to Mead, the Mayo Court clearly considered that the regulations were promulgated through notice-and-comment procedures—this fact was mentioned more than once in the opinion.

Inherent in the Chevron doctrine, though often overlooked in practice, is the fact that an agency's fulfillment of Chevron step one does not automatically lead to a judgment in favor of the agency on the deference question. The overwhelming number of courts confronted with a Chevron question, who found that a regu-

339. Mayo, 131 S. Ct. at 714.
340. In other words, the Court need not find that, just because the § 7805(a) regulations were granted Chevron deference in Mayo, the § 7805(a) regulations must be granted Chevron deference in Home Concrete.
341. Mayo, 131 S. Ct. at 714.
342. See supra note 265. It is true that the Mead Court did establish that a lack of notice and public comment, by itself, would not destroy a regulation's chance for Chevron deference. See United States v. Mead Corp., 533 U.S. 218, 231-32 (2001). However, this statement should not be read to excuse an agency's willful non-compliance with the APA. The reason is that the APA itself exempts certain regulations from notice-and-comment requirements. See Administrative Procedure Act, 5 U.S.C. § 553(b) (2006); see also supra note 73. Thus, a better reading of the foregoing statement from Mead is that, when a regulation is exempt from the APA's notice-and-comment requirements and that regulation is issued without notice-and-comment, the lack of public notice and opportunity for comment will not prevent that regulation from receiving Chevron deference. However, where a regulation is subject to the APA § 553 mandates and the agency chooses to forego such requirements, it has acted unreasonably and in violation of Chevron step two.
343. Mayo, 131 S. Ct. at 710, 714.
lation passed step one, have validated the regulation. These results could be interpreted to mean that challengers must win the *Chevron* step one battle or concede defeat, and some commentators have reasoned as such. However, where an agency has clearly acted unreasonably or arbitrarily in promulgating a regulation, courts have the discretion to refuse to defer to that regulation. This leads to the second critical aspect of the Court's suggested decision in *Home Concrete*—that APA-violative Treasury regulations fail *Chevron* step two.

Because of the discretion it affords to reviewing courts, step two of *Chevron* is where the judiciary can strike an appropriate balance between proper agency deference and blind agency faithfulness. As much as the issue may have been debated in the early to mid-twentieth century, it is now axiomatic that administrative

---

344. See Orin S. Kerr, *Shedding Light on Chevron: An Empirical Study of the Chevron Doctrine in the U.S. Courts of Appeals*, 15 YALE J. ON REG. 1, 31 (1998). Mr. Kerr conducted an empirical study of all cases in the United States Courts of Appeals between 1995 and 1996 that utilized the *Chevron* test. *Id.* at 4. Mr. Kerr found that, in the span of two years, courts applied the *Chevron* doctrine 253 times. *Id.* at 30. Of those 253 times (223 published cases), the courts accepted the agency's interpretation 73% of the time. *Id.* Of those courts which applied *Chevron*, the analysis was resolved at step one 38% of the time and at step two 62% of the time. *Id.* at 31. At step one, the agency views were upheld twenty-nine times and rejected forty times. *Id.* However, where the statute was declared ambiguous and the court moved on to step two, the agency constructions were accepted in 100 cases and rejected in only 12 cases. *Id.* In sum, if a challenger did not prevail at step one, he had only an 11% chance of winning the ultimate *Chevron* battle. See *id.* at 30-31.

345. Juan F. Vasquez & Peter A. Lowy, *Challenging Temporary Treasury Regulations: An Analysis of the Administrative Procedure Act, Legislative Reenactment Doctrine, Deference, and Invalidity*, 3 HOUS. BUS. & TAX L.J. 248, 273 (2003) ("Due to the difficulty of proving 'legislative regulations' are 'arbitrary, capricious, or manifestly contrary to the statute,' it becomes clear a taxpayer stands a much better chance of winning under *Chevron* if the statute is deemed unambiguous, thereby enabling a court to decide the case at step one.").

346. *Chevron*, U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 844 (1984). But cf. *Motor Vehicles Ass'n v. State Farm Mut. Auto Ins. Co.*, 463 U.S. 29 (1983). Although outside the context of *Chevron* per se, the Supreme Court has articulated the meaning of "arbitrary and capricious" for purposes of the APA. *State Farm*, 463 U.S. at 48. In *State Farm*, the Supreme Court held that the arbitrary and capricious standard of APA § 706(2)(A) requires agencies to articulate their reasons for choosing the particular interpretation adopted. *Id.* at 48. In a recent case before the Third Circuit Court of Appeals, Judge Ambro argued that a Treasury regulation (Treas. Reg. § 1.6015-5(b)(1)) should be considered substantively insufficient to pass *Chevron* step two, where the Treasury did not articulate its reasoning for promulgating such regulation. Mannella v. Comm'r, 631 F.3d 115, 127-28 (3d Cir. 2011) (Ambro, J., dissenting) ("[T]he IRS has not advanced any reasoning for its decision to impose a two-year limitations period on taxpayers . . . leaving us no basis to conduct the analysis mandated by *Chevron* step two . . . Because the IRS has not articulated its reasoning, we cannot discern whether the two-year limit falls into the permissible, or the arbitrary and capricious category."). And, critically, a United States Supreme Court decision issued in December of 2011 affirms that the review process of *State Farm* and the *Chevron* step two analysis are "the same," because both analyze the "arbitrary and capricious" standard of APA § 706(2)(A). See Judulang v. Holder, 132 S. Ct. 476, 483 n.7 (2011).
agencies are the proper and foremost interpreters of the statutes they are called to administer. However, never has Congress demanded that the judiciary follow every whim of the administrative state. When an administrative agency has abused its discretion—as broad as that discretion may be—it is proper for the courts to abate the agency's power.

The consistent lack of fidelity to the APA's procedural mandates demonstrates that the Treasury has abused its discretion in interpreting and administering the I.R.C. This is certainly not to say that the Treasury is some sort of evil empire, disregarding the rules out of spite. In fact, there are many sound policy reasons why the Treasury promulgates regulations outside of notice-and-comment. Substantial time and effort are required for an agency to comply with notice-and-comment procedural mandates, and taxpayers may request guidance on a more immediate basis.

Interim-final rulemaking can be viewed as a laudable compro-

---


348. Professor Hickman concisely explains the rationale behind notice-and-comment rulemaking and the balance that this manner of rulemaking attempts to strike, in her 2007 empirical study of the Treasury rulemaking practices, stating that: APA rulemaking requirements, combined with judicial review, are part of an effort to gain the benefits of agency manpower and expertise yet guard against the worst elements of agency behavior. Procedural requirements are perhaps most important when agencies act to dictate or restrict the actions of regulated parties with the force and effect of law, as through binding regulations. Legislative regulations are practically indistinguishable from the statutes under which they are promulgated, yet they are not derived from the same legislative process as statutes. Instead, the notice-and-comment procedures imposed by the APA on such regulations, with their emphasis on public participation, are an important if imperfect proxy for a more democratic legislative process.

Hickman, supra note 66, at 1805-06. Allowing the administrative state to function in a manner similar to other legislative bodies—and thereby function in a constitutionally-permissible manner—is the purpose behind notice-and-comment rulemaking. Because this policy rationale is so fundamental to the viability and constitutionality of the administrative state, an agency's failure to abide by notice-and-comment procedures is unreasonable and must be tempered by the courts.

349. The Treasury often cites the fact that taxpayers both need and desire immediate guidance as to how to follow the complex statutory schemes of the I.R.C. See, e.g., Guidance Under Section 1502, 69 Fed. Reg. 51,175, 51,176 (Aug. 18, 2004); Return of Partnership Income, 69 Fed. Reg. 12,068, 12,063 (Mar. 15, 2004); Effect of Elections in Certain Multi-Step Transactions, 68 Fed. Reg. 40,766, 40,767 (July 9, 2003); see also Internal Revenue Manual, supra note 14 (“These regulations are necessary to provide taxpayers with immediate guidance.”). This justification fails, however, due to the availability of other persuasive, yet non-binding, forms of guidance, such as Private Letter Rulings. See supra note 84.

350. See RICHARD J. PIERCE ET, JR., SIDNEY A. SHAPIRO & PAUL R. VERKUL, ADMINISTRATIVE LAW AND PROCESS § 6.4.6b, at 336 (4th ed. 2004) (“Promulgation of a single major rule often requires five to ten years and tens of thousands of agency staff hours.”).
mise—the Treasury, while technically violating the notice-and-comment requirements, still can consider commentary by the public before issuing final regulations.

The problem with the foregoing policy justifications is that the end (more efficient agency administration and quicker guidance to taxpayers) does not justify the means (willful violation of a fundamental statute). Agencies are bound to follow the mandates set forth by Congress, and may not eschew statues merely because it is more efficient or even, at times, beneficial to the public. The APA provides only a few well-defined exceptions to notice-and-comment rulemaking.\(^3\)\(^{5}\) When a regulation does not come within one of these exceptions, and an agency willingly foregoes notice-and-comment rulemaking anyway, it has abused its discretion and acted unreasonably. It has, from a plain textual reading, violated *Chevron* step two.

Finally, from a simple standpoint of fundamental fairness, it is viscerally disconcerting to allow an agency to influence the result of pending litigation to which that agency is also a party—especially when that agency violates administrative law through its actions. This is precisely what happened in *Home Concrete*. The Treasury did not issue an APA-violative rule in this case to administer quick and efficient guidance to taxpayers. It issued the regulation to overturn the unfavorable decisions it received at the trial level and guarantee a victory at the appellate level. Because the government is applying Treasury Regulation § 301.6501(e)-1 to all cases currently pending,\(^3\)\(^{2}\) it is axiomatic that the regulation applies to litigation in which the government is a party. This equates to the scenario described at the outset of this Article: a litigant issuing a rule that will affect the outcome of litigation, then demanding that the Court—that supposed final arbiter of the law\(^3\)\(^{3}\)—grant deference to the litigant’s rule.

As troubling as this scenario may seem, it would be legally acceptable if the rule was issued in compliance with the APA. A compliant rule would have at least given notice to the public and taken into account the public’s comments before becoming effective.\(^3\)\(^{4}\) However, without even this most basic assurance of fair-

---

354. As a practical matter, a rule issued with notice-and-comment would be less likely to affect ongoing litigation, as the events relevant to the litigation would have already been completed before the rule’s effective date. Moreover, unlike interim-final rulemaking, un-
ness, the policy behind tripartite government is all but eviscerated.\textsuperscript{355} Thus, in the case of APA-noncompliant regulations, the judiciary must be allowed to rein in the power of the administrative state and be permitted to use its own discretion when interpreting administrative regulations.\textsuperscript{356}

V. TAXPAYERS SHOULD NOT BE FORCED TO CHALLENGE PROCEDURALLY DEFICIENT REGULATIONS THROUGH AN APA CHALLENGE

A final argument remains in favor of upholding APA-violative regulations under \textit{Chevron}, and this argument addresses the proposed remedy rather than the regulation itself. That is, one could assert that the judicial deference doctrine is not the appropriate framework in which to analyze non-compliant regulations, because the APA itself provides a procedure for challenging violative regulations.\textsuperscript{357} Thus, taxpayers or other interested parties could conceivably challenge non-compliant regulations before they are ever enforced.\textsuperscript{358} Obviously, this would make the \textit{Chevron} question moot, because non-compliant regulations would be challenged at the outset of their promulgation, and the IRS would never have the opportunity to utilize them in a case before the court. However, along with the practical and psychological reasons why taxpayers may forgo many APA challenges, two important statutory

dertaking notice-and-comment before a rule is made effective allows the public to actively participate in the rulemaking, rather than fight against an already-binding rule that the agency seems unlikely to change. See supra text accompanying note 69.

\textsuperscript{355} See supra text accompanying notes 62-64 (explaining that the strictures of the APA were put in place to ensure that administrative rulemaking stayed faithful to the ideals underlying the balance and separation of powers).

\textsuperscript{356} The idea that a court would have discretion to not defer to an administrative regulation does not mean that the court would necessarily choose this course. Discretion not to defer also means that the court would have discretion to defer. Luckily, existing jurisprudence provides a bounty of factors that courts could examine when deciding whether or not to defer to a regulation. See, e.g., Skidmore \textit{v. Swift & Co.}, 323 U.S. 134, 140 (1944). The Court stated in \textit{Mead} that, when confronted with an administrative regulation, the choice is not between mandatory \textit{Chevron} deference and no deference at all. United States \textit{v. Mead Corp.}, 533 U.S. 218, 226 (2001) (deciding that the regulation at issue was not entitled to mandatory \textit{Chevron} deference, but that it may be entitled to some (persuasive-if-not-binding) level of deference). Holding that APA-violative regulations are not entitled to \textit{Chevron} deference only means that courts could follow the regulation's guidance, if prudent, or issue their own interpretations.


\textsuperscript{358} Some may argue that this is the only viable means to challenge a non-compliant regulation. In other words, if a taxpayer foregoes challenging a regulation for procedural reasons when it is promulgated, she should not later be allowed to argue against that regulation on procedural grounds—she has missed the window of opportunity.
obstacles also lie in the way of a taxpayer’s pre-enforcement challenge to procedurally defective Treasury regulations: I.R.C. § 7421 and the Declaratory Judgment Act.

I.R.C. § 7421(a) ("AIA") provides that "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person, whether or not such person is the person against whom such tax was assessed." Several narrow exceptions to this general rule do exist, most procedural in nature. Similarly, the Declaratory Judgment Act ("DJA") contains a tax exception, which prevents courts from providing declaratory relief for controversies "with respect to Federal taxes." Federal courts have often agreed that the two statutes work conterminously.

The Supreme Court has interpreted the policy of both the AIA and the DJA as one of administrative efficiency, stating that the purpose of both statutes is "to permit the United States to assess and collect taxes alleged to be due without judicial intervention, and to require that the legal right to the disputed sums be determined in a suit for refund . . . ." Thus, the AIA and the DJA work to facilitate the "prompt collection of [the government's] lawful revenue." These statutory provisions reinforce the general revenue collection rule of "pay first, litigate later."

Although the AIA and the DJA are facially directed at controversies involving individual tax collection, the Court interprets these provisions broadly to preclude pre-enforcement review of tax cases raising questions beyond the liabilities of individual taxpay-

359. I.R.C. § 7421(a) (West 2012). This code provision is often referred to as the Anti-Injunction Act ("AIA") and bars many pre-enforcement challenges based on the I.R.C. See United States v. Clintwood Elkhorn Mining Co., 553 U.S. 1, 9-10 (2008).

360. See, for example, I.R.C. § 7421(a), which permits judicial review when the IRS attempts to collect taxes without mailing the taxpayer a notice of deficiency. See also id. § 6213(a) (precluding assessment without notice of deficiency); id. § 6212(a) (authorizing notices of deficiency by certified or registered mail); id. § 7421(a) (establishing violations of I.R.C. § 6212(a) as an exception to the general rule).

361. Declaratory Judgment Act, 28 U.S.C. § 2201(a) (West 2012). Like I.R.C. § 7421(a), this statute provides certain narrow exceptions, which are not applicable in the run of the mill case wherein a taxpayer wishes to challenge the Treasury’s violation of the APA. Id.


364. Williams Packaging, 370 U.S. at 7.

The United States Supreme Court has extended the application of these statutes to claims that have only indirect bearing on Federal revenue collection. For example, the AIA barred a taxpayer’s petition for injunctive and declaratory relief where the petition, if granted, would have had the effect of reducing other individuals’ tax liabilities. Lower courts have followed suit, denying judicial review of Treasury regulations that merely “concern” the collection of federal taxes, whether or not they directly impact the individual liability of the taxpayer bringing the claim.

Moreover, very few common law exceptions to the AIA and the DJA exist, and these exceptions have been applied narrowly. In *Enochs v. Williams Packing & Navigation Co.*, the Supreme Court held that a taxpayer’s claim is not subject to I.R.C. § 7421 if: (1) “under no circumstances could the Government ultimately prevail,” and (2) “the taxpayer would suffer irreparable injury if collection were effected.” Because it would be the very rare case in which the government could not even assert a colorable position for its attempted collection, the *Williams Packaging* exception to the general bar against pre-enforcement review in tax cases is not much of a weapon for taxpayers.

The other judicially recognized exception to I.R.C. § 7421 is enunciated in *South Carolina v. Regan*. Therein, the Court held


367. *In Bob Jones Univ.*, a private university sought relief from an IRS threat to withdraw the university’s tax-exempt status due to race-based admissions policies. 416 U.S. at 725. The Supreme Court found that the university’s petition would have the effect of “restrain[ing] the . . . collection of taxes” from the university’s donors, if not the university itself, because the IRS would be forced to “continue to provide assurance to those donors that contributions to [the university] will be recognized as tax deductible, thereby reducing their tax liability.” *Id.* at 738-39.

368. *See, e.g., Debt Buyers’ Ass’n v. Snow*, 481 F. Supp. 2d 1,15-16 (D.C. Cir. 2006) (holding that consumer information reporting regulations could not be reviewed, because the reported information would assist the IRS in determining the tax liability of other taxpayers relative to income from discharged debt); *Foodservice & Lodging Inst. v. Regan*, 809 F.2d 842, 844 (D.C. Cir. 1987) (holding that pre-enforcement judicial review of regulations governing how restaurant employers allocate and report tip income among employees was barred by I.R.C. § 7421(a) (1982) and the Declaratory Judgment Act, 28 U.S.C. § 2201 (Supp. III 1985)).


370. In fact, the United States Supreme Court has never actually applied *Williams Packaging* to find jurisdiction over a case. *See Hickman, supra* note 110, at 1171 (discussing cases in which the *Williams Packaging* exception was discussed but ultimately rejected). Lower courts have only utilized this exception in cases of “obvious and egregious IRS error or flagrant IRS disregard of established law combined with significant financial imposition upon the taxpayer.” *Id.*

that the AIA will not apply to preclude pre-enforcement challenges only where the taxpayer has no other legal remedy available.\textsuperscript{372} Unfortunately for the would-be challenger, federal courts have repeatedly stated that the taxpayer always has the available legal remedy of paying the tax and challenging it via a refund action.\textsuperscript{373} Therefore, it seems highly unlikely that \textit{South Carolina v. Regan}\textemdashwith its mandate that a taxpayer have no other legal remedy available\textemdashcould be used to initiate a pre-enforcement challenge of procedurally defective Treasury regulations.

Likewise, there are many practical reasons why a taxpayer may not bring an APA challenge to procedurally infirm regulations, even post-enforcement. Because the courts so often remind us that taxpayers have the option of paying a tax then suing for a refund,\textsuperscript{374} one may assume that taxpayers could easily raise APA challenges during their refund actions. However, as with pre-enforcement review, there are serious limitations on a taxpayer’s ability to bring an enforcement-based APA challenge.

First, in order to obtain judicial review via a refund claim, a taxpayer must first pursue an administrative review process outlined in the I.R.C.\textsuperscript{375} Refund claims arise when a taxpayer requests a refund of taxes already paid, and the IRS either rejects the claim or fails to act within six months.\textsuperscript{376} Deficiency litigation arises in a similar fashion: the IRS concludes that a taxpayer owes additional taxes or penalties and issues a notice of deficiency, which the taxpayer contests in Tax Court.\textsuperscript{377}

Though the refund process sounds simplistic and is often cited by courts as an adequate remedy, refund claims are subject to thorough administrative review by the IRS.\textsuperscript{378} In other words, by submitting a refund claim, a taxpayer subjects herself to the equivalent of a second audit. This raises the risk that the IRS will find additional issues and claim underpayment.\textsuperscript{379} For many tax-

\begin{itemize}
  \item \textsuperscript{372} Regan, 465 U.S. at 378, 380-81.
  \item \textsuperscript{373} See, e.g., United States v. Clintwood Elkhorn Mining Co., 553 U.S. 1, 4-5 (2008); Liberty Univ., Inc. v. Geithner, 671 F.3d 391, 401 (4th Cir. 2011).
  \item \textsuperscript{374} See supra note 365.
  \item \textsuperscript{375} See I.R.C. § 7422(a) (2000) (stating that a taxpayer must exhaust administrative remedies with the IRS before pursuing a refund claim in court).
  \item \textsuperscript{376} Id.; id. § 6532(a)(1).
  \item \textsuperscript{377} See id. § 6211(a); id. § 6212(a); id. § 6213(a) (defining and authorizing deficiencies and petitions).
  \item \textsuperscript{378} See Treas. Reg. § 601.105(e)(2) (1987) (stating that the examination of refund claims is subject to the same procedure and level of scrutiny as general audits).
  \item \textsuperscript{379} See Gerald A. Kafka & Rita A. Cavanagh, Litigation of Federal Tax Controversies § 14.01 (2d ed. 1995) (noting that on administrative refund claims, the IRS
payers, this risk outweighs the potential benefit of raising an APA challenge.

In addition, taxpayers may be offered a settlement during the IRS appeals process. The ability of an individual to escape the appeals process by paying only a fraction of his total liability exposure may make settlement an attractive option in many cases. Of course, when the settlement occurs entirely within the IRS administrative review process, there is no opportunity for judicial review of the pertinent Treasury regulations. Not only is this method of settling claims beneficial for the taxpayer, but the IRS also benefits. Settlement agreements are confidential. Thus, if the IRS Appeals Officer knows that the taxpayer has a potential APA challenge, the practical likelihood that the IRS and the taxpayer will

often looks beyond the issues raised by the taxpayer in hopes of finding offsetting liabilities).


381. In this way, taxpayers are unique from other administratively regulated persons and entities. Would-be challengers of Treasury regulations are often individuals or businesses with nonrecurring interpretive issues. For example, an individual taxpayer may find himself faced with a procedurally-defective Treasury regulation that impacts his refund claim. This taxpayer may have engaged in a transaction that is unlikely to recur, such as the sale of a business, the disposition of a capital asset, or the administration of an estate. For this taxpayer, the benefit of challenging the regulation on procedural grounds in court would not be substantial, as, even if he were successful, he would not ever have to deal with the regulation again. Furthermore, the procedurally-defective regulation may not even be dispositive of his claim; thus, a taxpayer could win his APA claim and still lose his refund claim. The risks he would incur, however, should he forgo the appeals process and bring his refund claim to court would likely be great. He would risk the court upholding the regulation and would lose the chance to settle his refund claim. Quite simply, many taxpayers do not have the necessary incentive to bring their refund or deficiency claims to court and thereby request judicial review of procedurally-infirm Treasury regulations.

This scenario stands in sharp contrast to the situations of other regulated entities who commonly do bring APA challenges. For example, a steelmaker who is affected by a procedurally-defective EPA regulation has incentive to obtain judicial review of this regulation. The EPA regulation does not affect the steel industry on a one-time basis, but rather will affect industry-wide operations for as long as the regulation is in existence. Furthermore, the steelmaker does not expose itself to additional penalties (like the taxpayer does by exposing himself to the risk of a second audit) should he challenge the administrative regulation in court. The benefit of invalidating a defective EPA regulation will therefore be worth the costs of bringing an APA claim before the court.

382. I.R.C. § 6103(a).
end up settling without judicial intervention increases.\textsuperscript{383} Again, though mutually beneficial, this outcome absolutely prevents judicial review of APA-violative Treasury regulations.\textsuperscript{384}

Finally, from a psychological standpoint, taxpayers may perceive futility in challenging Treasury regulations that fail to comply with the APA, especially, as in \textit{Home Concrete}, when the infirmities have been “cured” by the issuance of final regulations. As noted \textit{supra}, the Treasury most often violates the APA, and did so in \textit{Home Concrete}, by issuing legally-binding temporary regulations without notice-and-comment and following up with often-indistinguishable final regulations.\textsuperscript{385} As explained \textit{supra}, the very nature of the Treasury’s violation gives taxpayers the idea that a procedural challenge will be fruitless—the Treasury has already made up its mind, and a procedural challenge would only delay the inevitable.\textsuperscript{386}

In sum, many legal and practical impediments stand in the way of both pre- and post-enforcement challenges to procedurally-infirm regulations under the APA itself. In many cases, the only chance a taxpayer will have to challenge the effect of the regulation is before a court faced with the \textit{Chevron} question. The court will then decide whether it must defer to the agency’s interpretation, even when that agency did not follow the APA in promulgating its interpretation, or utilize its own discretion to interpret the...
applicable statute. And armed with *Chevron's* demand of reasonableness, that taxpayer can ask the court to take a stand and hold the agency accountable for violating statutory mandates.

VI. CONCLUSION

In twenty-first century American government, separation of powers is undeniably fundamental, while the administrative state is absolutely necessary. Because the ideal of checks and balances must co-exist with the reality of rule by administrative law, Congress has struck a balance via the APA. This act provides administrative agencies with a blueprint for promulgating binding regulations and strives to ensure that public notice and participation will be as much a part of administrative rulemaking as it is in legislative lawmaking.

Home Concrete presented the Supreme Court with the perfect opportunity to hear a case in which an administrative agency has violated its APA rulemaking requirements, and an affected party is challenging that violation under *Chevron*. Surprisingly, the Court completely eschewed the issue, failing to provide any guidance on whether APA-violative regulations will be afforded deference. Because the Court's decision in *Home Concrete* provided no elucidation on whether procedurally defective administrative regulations will be upheld or invalidated under *Chevron*, it is highly unlikely that the Treasury's rulemaking practices will drastically change, and it is almost inevitable that another APA-based challenge will appear before the Court in the (hopefully near) future. Taxpayers can only hope that the next time the Court has the opportunity to face a challenge to an APA-violative regulation it will do so head on, invalidate the regulation, and thereby inform the country's most powerful administrative agency that the rules really do apply to all of us.